Master of Business Administration
Semester-I
MBCI - 3 – Accounting for Managers
CONTENT

PROGRAM EDUCATIONAL OBJECTIVES (PEO)

Our program will create graduates who:

1. Will be recognized as a creative and an enterprising team leader.
2. Will be a flexible, adaptable and an ethical individual.
3. Will have a holistic approach to problem solving in the dynamic business environment.

Course Objective : MBCI - 3– Accounting for Managers

CO1 Given an accounting situation Students will be able to apply the accounting Concept & Convention to arrive at appropriate result.

CO2. Given the Trial Balance and accompanying financial adjustments the future manager shall be able to ***prepare*** the financial statements and ***calculate*** the profit or loss of a firm as at the end of the financial year.

CO3. Given the financial statements a student will be able to ***perform*** Cash Flow analysis to ***evaluate*** whether a firm is doing well financially and has sufficient cash to meet its obligations and support its growth or not.

CO4. Given the financial statements a student will be able to ***perform*** Ratio analysis to ***ascertain*** whether a firm is doing well or not as compared to its peers and also on a year on year basis.

CO5. Given details of cash expenses and incomes, the student will be able to ***prepare*** cash budget and shall be able to ***determine*** the cash position for a given period.

CO6. Given details of expenses a student will be able to classify fixed, variable and semi-variable expenses and + incomes, ***construct*** flexible budget and shall be able to ***conclude*** the profitability for a given period.

MBCI - 3 – Accounting for Managers

Unit-I: Introduction to Accounting*: Introduction of financial accounting, Importance, Objectives and Principles of Accounting, Concepts and conventions, and The Generally Accepted Accounting Principles (GAAP),* ***Introduction of Accounting Process****- Journal and ledger, Trial Balance, Classification of capital and revenue expenses, preparation of subsidiary books and cash book. Reconciliation between bank pass book and cash book.*

Unit II: Final Accounts of Joint Stock Companies - *Final Accounts of Joint Stock Companies –contents, and preparation of Trading and Manufacturing, Profit and Loss Account, Profit and Loss Appropriation Account and Balance sheet with adjustments as per Schedule III of the Companies Act, 2013, Provisions for Statutory Audit.*

Unit III: Interpretation of Financial Statements: Cash Flow Analysis *– Meaning and Purpose of Cash Flow Statement, Format of Cash Flow Statement (AS3), Cash Flow from Operating Activities, Uses and Limitations of Cash Flow Analysis –* ***Ratio Analysis*** *– Meaning, Need, Advantages and Limitations of Ratio Analysis, Classification of Ratios: Profitability Ratios, Liquidity Ratios and Activity Ratios, Projections through Ratios.*

Unit IV: Budgeting and Budgetary Control *– Concept of Budgeting and Budgetary Control, Types of Budgets, Static and Flexible Budgeting, Preparation of Cash Budget, Sales Budget, Production Budget and Master Budget, Essential features, Merits and Limitations of Budgetary Control.*

Suggested Readings:

- Bhagavati & Pillai: Management Accounting
- Hanif & Mukherjee: Financial Accounting – Vol. II, Tata McGraw Hill
- Dr.S.N. Maheshwari and Dr.S.K. Maheshwari: Financial Accounting, Vikas, 2009.
- Ambrish Gupta: Financial Accounting Management An Analytical Perspective, Pearson Education-2009
- Stice & Stice: Financial Accounting Reporting & Analysis, Cengage, 7/e, 2008.

Unit-I: Introduction to Accounting

Accounting has rightly been termed as the language of the business. We can use this language to communicate financial transactions and their results. It records, classifies, analyses and communicates all the business transactions that have taken place during a particular period. It is a system of recording and reporting business transactions in financial terms, to interested parties.

According to American Institute of Certified Public Accounts "Accounting is the art of recording, classifying and summarizing in a significant manner in terms of money, transactions and events which are , in part at least, of a financial character and interpreting the results there of" . Thus accounting is the art of recording, classifying, summarizing, analyzing and interpreting the financial transactions and communicating the result s thereof to the interested person.

Financial accounting assists keeping a systematic record of financial transactions the preparation and presentation of financial reports in order to arrive at a measure of organizational success and financial soundness. It relates to the past period, serves the stewardship function and is monetary in nature. It is primarily concerned with the provision of financial information to all stakeholders.

Features or characteristics or nature of Accounting

Following are the features of accounting:-

1) Accounting is an art.
2) Accounting is a science.
3) Recording of business transactions.
4) Classifying business transactions.
5) Summarizing the classified data
6) Analysis and interpret the summarized data
7) Communicating information to the interested parties.
8) Records transaction and events which are financial character.

Objectives of Accounting

Let us go through the main objectives of Accounting:

- **To keep systematic records:** Accounting is done to keep systematic record of financial transactions. The primary objective of accounting is to help us collect financial data and to record it systematically to derive correct and useful results of financial statements.
- **To ascertain profitability:** With the help of accounting, we can evaluate the profits and losses incurred during a specific accounting period. With

the help of a Trading and Profit & Loss Account, we can easily determine the profit or loss of a firm.

- **To ascertain the financial position of the business:** A balance sheet or a statement of affairs indicates the financial position of a company as on a particular date. A properly drawn balance sheet gives us an indication of the class and value of assets, the nature and value of liability, and also the capital position of the firm. With the help of that, we can easily ascertain the soundness of any business entity.
- **To assist in decision-making:** To take decisions for the future, one requires accurate financial statements. One of the main objectives of accounting is to take right decisions at right time. Thus, accounting gives you the platform to plan for the future with the help of past records.
- **To fulfil compliance of Law:** Business entities such as companies, trusts, and societies are being run and governed according to different legislative acts. Similarly, different taxation laws (direct indirect tax) are also applicable to every business house. Everyone has to keep and maintain different types of accounts and records as prescribed by corresponding laws of the land. Accounting helps in running a business in compliance with the law.
- **Maintenance of Records** of Business Transactions: Accounting is used for the Maintenance of a systematic record of all financial transactions in book of accounts. When the most brilliant executive or manager cannot accurately remember the numerous amount of varied transactions such as purchases, sales, receipts, Payments, etc. that takes place in business every day. Hence, a proper and complete records of all business transactions are kept regularly. Moreover, the recorded information enables verifiability and acts as evidence.
- **Calculation of Profit And Loss** The owners of business are keen to have an idea about the net results of their business operations periodically, i.e. whether the business has earned profits or incurred losses. Thus, another objective of accounting is to ascertain the profit earned or loss sustained by a business during an Accounting period which can be easily workout with help of record of incomes and expenses relating to the business by preparing a profit or loss account for the period.
- **Depiction of Financial Position: -** Accounting also aims at ascertaining the financial position of the business Concern in the form of its assets and liabilities at the end of every accounting period.

Advantages

i. Permanent and Reliable Record: Book-keeping provides permanent record for all business transactions, replacing the memory which fails to remember everything.

ii. Arithmetical Accuracy of the Accounts: With the help of book keeping trial balance can be easily prepared. This is used to check the arithmetical accuracy of accounts.

iii. Net Result of Business Operations: The result (Profit or Loss) of business can be correctly calculated.

iv. Ascertainment of Financial Position: It is not enough to know the profit or loss; the proprietor should have a full picture of his financial position in business. Once the full picture (say for a year) is known, this helps him to plan for the next year's business.

v. Ascertainment of the Progress of Business: When a proprietor prepares financial statements every year, he will be in a position to compare the statements. This will enable him to ascertain the growth of his business. Thus book keeping enables a long range planning of business activities besides satisfying the short term objective of calculation of annual profits or losses.

vi. Calculation of Dues: For certain transactions payments may be made later. Therefore, the businessman has to know how much he has to pay others.

vii. Control over Assets: In the course of business, the proprietor acquires various assets like building, machines, furniture, etc. He has to keep a check over them and find out their values year after year.

viii. Control over Borrowings: Many businessmen borrow from banks and other sources. These loans are repayable. Just as he must have a control over assets, he should have control over liabilities.

ix. Identifying Do's and Don'ts: Book keeping enables the proprietor to make an intelligent and periodic analysis of various aspects of the business such as purchases, sales, expenditures and incomes. From such analysis, it will be possible to focus his attention on what should be done and what should not be done to enhance his profit earning capacity.

x. Fixing the Selling Price: In fixing the selling price, the businessmen have to consider many aspects of accounting information such as cost of production, cost of purchases and other expenses. Accounting information is essential in determining selling prices.

xi. Taxation: Businessmen pay sales tax, income tax, etc. The tax authorities require them to submit their accounts. For this purpose, they have to maintain a record of all their business transactions.

xii. Management Decision-making: Planning, reviewing, revising, controlling and decision-making functions of the management are well aided by book-keeping records and reports.

xiii. Legal Requirements: Claims against and for the firm in relation to outsiders can be confirmed and established by producing the records as evidence in the court.

Limitations of Accounting

Accounting suffers from the following limitations:

1. It is historical in nature.
2. Transactions of non-monetary nature will not be recorded in accounting.
3. Information recorded in accounts is influenced by the personal judgment of the accountant.
4. In accounting valueless assets are also shown.
5. In accounting price changes are not considered.
6. It is not an exact science.
7. Use of different accounting methods reduces the reliability of accounts.
8. Account records show only actual cost figures.

Accounting Concepts: Concepts mean a general idea which conveys certain meaning. Accounting concepts may be considered as basis assumption or conditions on which the science of accounting is based. Concepts are based on logical consideration. Accounts and Financial statements are always interpreted in light of concepts which govern accounting method. Different accounting concepts are discussed as follows:

A. Business Entity Concepts

According to Entity concept, business is treated as a unit of entity form separate from its Owner, Creditors and Management etc. Accounts are kept for business entity as distinguished from a person associated with it. All business transactions are recorded in the books of Accounts from the point of view of business only. Every type of business organisation is treated as separate Accounting entity. The failure to recognise the business as separate accounting entity would make it extremely difficult to evaluate the performance of business alone. The overall effect of adopting this concept is

1) Only the business transactions are reported and not the personal transactions of the owners
2) Profit is the property of business unless distributed to the owners.

3) The personal assets of the owners are not considered while recording and reporting the assets of the business entity.

B. Going Concern Concept: Business transactions are recorded on the assumption that the business will continue for a long time. There is neither the intention nor the necessity to liquate the particular business i n near future. Therefore, it would be able to meet its contractual obligation and use its resources according to the plans and predetermined goals. Therefore, Fixed Assets are recorded at cost and depreciation is calculated on cost / written down value. Similarly prepaid expenses are treated as Assets on the presumption that the business will continue and these expenses will be utilized in future. When an enterprise liquidates a branch or one division or one segment of its business the ability of the enterprise to continue as a going concern is not imparted. In case of enterprise going to liquidate or become insolvent. Then the enterprise cannot be considered as a going concern.

C. **Money Measurement Concept** A unit of exchange and measurement is necessary to account for business transaction in a uniform manner. Money is common denominator in terms of which the exchange ability of goods and services are measured. Only such transactions and events as can be interpreted in terms of money are recorded. Non-monetary events like public political contract, location of business; certain disputes, efficient Sales Force etc. cannot be recorded in the books of Accounts even through these have great effects. However, a unit of money measurement over period of time has its own drawbacks. Money has time value, which cannot be considered. Time value of money is affected seriously by economic differences etc. System of accountancy treats all units of money same irrespective of time of original and settlement of it say after two years. It will be the same amount. However value of Money true sense will be less. This is a great drawback. This leads to the introduction of inflation accounts.

D. Cost Concepts:-According to cost concept the various assets acquired by enterprise should be recorded on the basis of actual cost incurred. The cost concept does not mean that the basis for all subsequent accounting for the assets. As per cost concept Fixed Assets are shown at cost less depreciation charged from year to year. It may be noted that if nothing has been paid for acquiring something it would not be shown/recorded in the books of accounts maintain. Financial statement based on historical cost may not be much relevant for investors and other users because they are more interested in knowing what the business actually worth today rather than the original cost.

E. Accounting Period Concept It is customary that the life of the business is divided into appropriate parts or segments of analysing the results shown by the business. Each part divided is known as an accounting period. It is an internal of time at end of which the income statement and balance sheet are prepared. Normally the accounting period consists of twelve months.

F. **Duel Aspect Concept** This concept based on double Entry book - keeping which means that Accounting system is set up in such a way that a record is made of the two aspects of each transaction that affects the record. The recognition of the two aspects of every transaction is known as duel aspects concept. Modern Financial Accounting considers both aspects of every transaction. One entry consists of debit to one or more accounts and another effect consist of credit to some other one or more accounts. However, the total amount debited is always equal to the total amount credited. Therefore at any point of time total assets of a business are equal to its total liabilities. Liabilities to outsider are known as liabilities, liabilities to the owner are referred to as capital.

Assets = Liabilities + Capital

Therefore, Capital = Assets –Liabilities

Assets refer to valuable things owned by the business, Capital refers to the owner's contribution to the business.

G. **Accrual Concept** This accounting concept states that revenue is recognised when they are earned and when they are not received similarly, cost are recognised as and when they are incurred and not when they are paid. This concept implies that the income should be measured as difference between revenues and expenses rather that the difference between cash received and disbursements. Therefore certain adjustments are required while preparing Final Accounts. In case of revenue accounts; prepaid expenses, outstanding expenses, Income received in advance / Receivable are adjusted. These adjustments have their impact on both the income statement and the Balance sheet.

H. Matching Cost Concept This concept is based on accounting period concept for determining accurate profit / Income has to compare the revenues of the business with the cost that is incurred to earn that revenue. The term "Matching" means appropriate association of related revenues and expenses. According to this concept adjustments should be made for all outstanding expenses, income receivable, prepaid expenses, Income received in advance, depreciation etc. While preparing final accounts at the end of accounting period.

I. Realisation Concept This accounting concept explains that sell is supposed to be completed only when ownership of goods are passed on from the seller to the buyer. Income is considered to be earned on the date when sales take place. No profit is supposed to accrue on the acquisition of anything, however, income earned / realised will be earn only when goods are sold at a profit. Therefore closing stock is valued at cost or market price whichever is less. It prevents business Firms from inflecting their profits by recording income that is expected in future.

J. Verifiable and Objective Evidence Concept: This principle requires that each recorded business transactions in the books of accounts should have an adequate evidence to support it. For example, cash receipt for payments made. The documentary evidence of transactions should be free from any bias. As accounting records are based on documentary evidence which are capable of verification, it is universally acceptable.

Accounting Conventions: The term 'Convention' denotes customs or traditions or practice based on general agreement between the accounting bodies which guide the accountant while preparing the financial statements.

A. Convention of Disclosure:- According to convention of full disclosure, accounting must disclose all the material facts and information so that interested parties after reading such accounting report can get a clear view of the state of affairs of the business. All information which are of material interest to proprietors, creditors and investors should be disclosed in accounting statement.

The Companies Act makes various provisions for disclosure of essential information that there is no chance of any material information being left out.

B. Convention of Materiality:-The term material means "relative importance", Accounting to the convention of materiality; account should report only what is material and ignore insignificant details while the preparing the final accounts. Materiality will differ or changed with nature, size and tradition of the business. What is material for one enterprise may be immaterial for another enterprise. This is because otherwise accounting will unnecessarily be overburdened with minute details. It is not possible to lay down any fixed standard by which Materiality can be judged. The decision is to be made by the accountant or the Auditor based on their professional experience

C. Convention of Consistency:- This accounting convention state that one's a particular accounting practice, method or policy is adopted to prepare accounts, statements and Reports. It should be continued for years together and should not charge unless it is forced to change it. Accounting practices should remain the same from one year to another. The results of different years will be comparable only when accounting rules are continuously adhered to from years to years i.e . Valuation of stock in trade, method of depreciation, treatment of approval sale etc. Since methods of accounting consistence the financial statements are reliable to the people who use it.

D. Convention of Conservatism: Financial Statements are usually drawn up on a conservative basis. There are two principles which stem directly from conservatism.

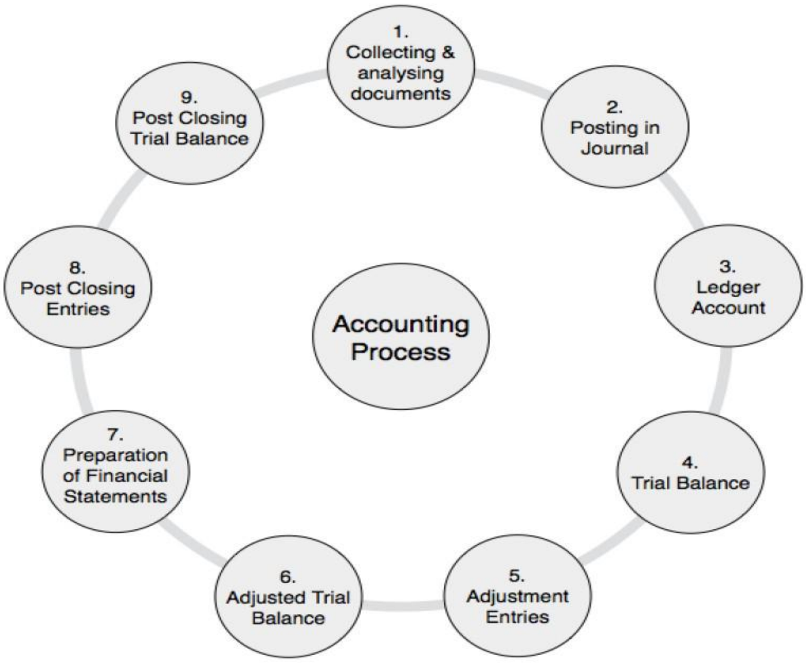
a) The accountant should not anticipate income and should provide all possible losses, and

b) Faced with the choice between two methods of valuing an asset the accountant should choose a method which leads to the lesser value. It is also called "Principles of prudence". Therefore, provision for bad and doubtful debts is also permitted and made every year.

Accounting convention must be followed continuously. If not followed continuously it would result into understatement of incomes, assets and overstatement of liabilities and provisions and expenses

Accounting Process: -

Accounting cycle refers to the specific tasks involved in completing an accounting process. The length of an accounting cycle can be monthly, quarterly, half-yearly, or annually. It may vary from organization to organization but the process remains the same. The following chart shows the basic steps in an accounting cycle:



Accounting Process

Collecting and Analyzing Accounting Documents: - It is a very important step in which you examine the source documents and analyse them. For example, cash, bank, sales, and purchase related documents. This is a continuous process throughout the accounting period.

Posting in Journal: - On the basis of the above documents, you pass journal entries using double entry system in which debit and credit balance remains equal. This process is repeated throughout the accounting period.

Posting in Ledger Accounts: - Debit and credit balance of all the above accounts affected through journal entries are posted in ledger accounts. A ledger is simply a collection of all accounts. Usually, this is also a continuous process for the whole accounting period.

Preparation of Trial Balance :- As the name suggests, trial balance is a summary of all the balances of ledger accounts irrespective of whether they carry debit balance or credit balance. Since we follow double entry system of accounts, the total of all the debit and credit balance as appeared in trial balance remains equal. Usually, you need to prepare trial balance at the end of the said accounting period.

Posting of Adjustment Entries: - In this step, the adjustment entries are first passed through the journal, followed by posting in ledger accounts, and finally in the trial balance. Since in most of the cases, we used accrual basis of accounting to find out the correct value of revenue, expenses, assets and liabilities accounts, we need to do these adjustment entries. This process is performed at the end of each accounting period.

Adjusted Trial:- Balance Taking into account the above adjustment entries, we create adjusted trial balance. Adjusted trial balance is a platform to prepare the financial statements of a company.

Preparation of Financial Statements: - Financial statements are the set of statements like Income and Expenditure Account or Trading and Profit & Loss Account, Cash Flow Statement, Fund Flow Statement, Balance Sheet or Statement of Affairs Account. With the help of trial balance, we put all the information into financial statements. Financial statements clearly show the financial health of a firm by depicting its profits or losses.

Post-Closing Entries: - All the different accounts of revenue and expenditure of the firm are transferred to the Trading and Profit & Loss account. With the result of these entries, the balance of all the accounts of income and expenditure accounts come to NIL. The net balance of these entries represents the profit or loss of the company, which is finally transferred to the owner's equity or capital account. We pass these entries only at the end of accounting period.

Post-Closing Trial Balance: - Post-closing Trial Balance represents the balances of Asset, Liabilities & Capital account. These balances are transferred to next financial year as an opening balance.

The Generally Accepted Accounting Principles (GAAP)

What are 'Generally Accepted Accounting Principles - GAAP?'

Accounting standard put together provides a framework of norms as to recognition, measurement and disclosure on the part of all enterprises that follow them to ensure comparability and depiction of true and fair view of the Financial Statements. High quality accounting standards are a prerequisite and important for all stakeholders of a business. The surge in the cross-border capital raising and Investment transactions demands formulation of high quality international accounting standard for financial reporting worldwide.

The various factors that have led to difference in accounting practices comprise widely of the culture, traditions, economic development, economic growth mode, inflation, legal system etc.

The diversity demands unification to the extent possible to develop Generally Accepted

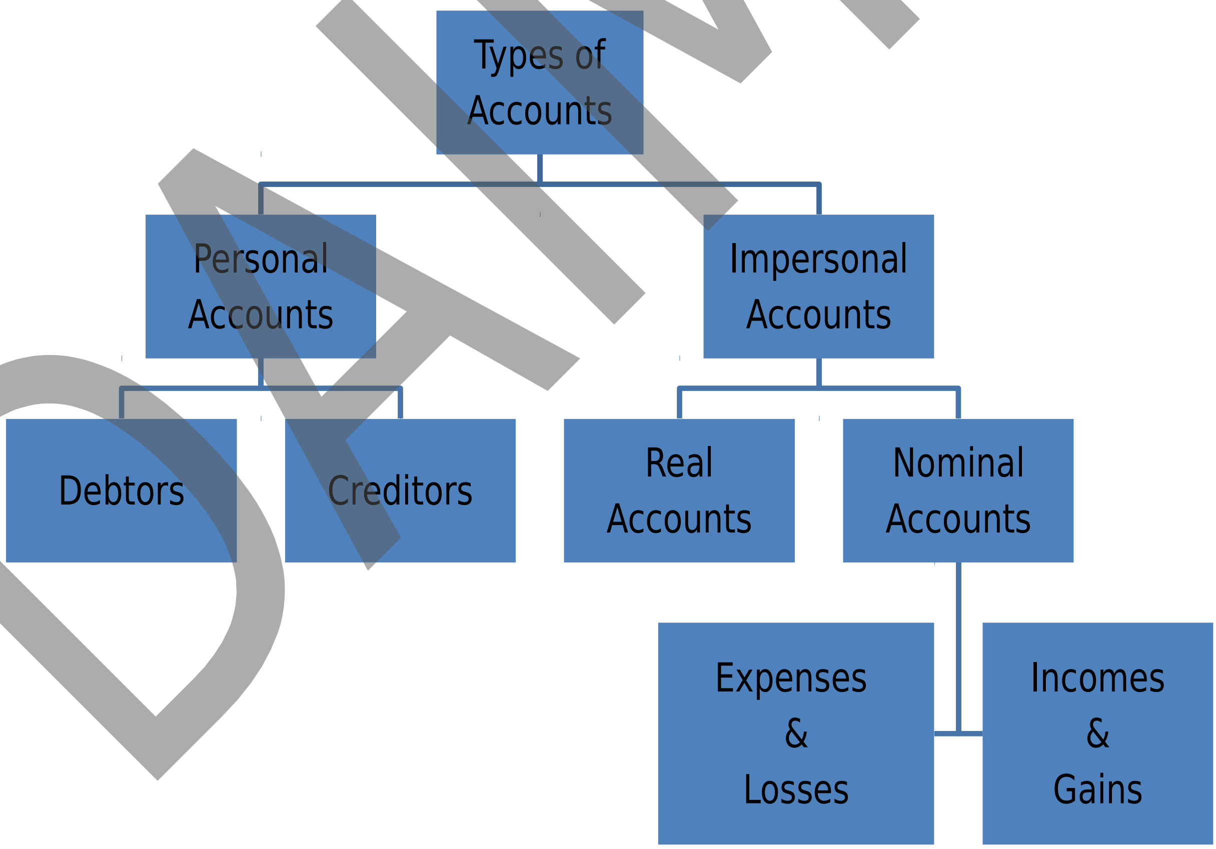
Accounting Practices (GAAP). Indian GAAP comprises of a set of pronouncement issued by various regulatory authorities mostly in consultation with the ICAI. The accounting standard i.e. Indian GAAP is supplemented by Guidance notes, Interpretation, General Clarification and revision from time to time.

A widely accepted set of rules, conventions, standards, and procedures for reporting financial information, as established by the Financial Accounting Standards Board are called Generally Accepted Accounting Principles (GAAP).

These are the common set of accounting principles, standards and procedures that companies use to compile their financial statements. GAAP are a combination of standards (set by policy boards) and simply the commonly accepted ways of recording and reporting accounting information. GAAP is to be followed by companies so that investors have an optimum level of consistency in the financial statements they use when analyzing companies for investment purposes. GAAP covers such aspects like revenue recognition, balance sheet item classification and outstanding share measurements.

Classification of Accounts

It is necessary to know the classification of accounts and their treatment in double entry system of accounts. Broadly, the accounts are classified into:



- **Personal accounts**
- **Real accounts**

    - Tangible accounts
    - Intangible accounts
- **Nominal accounts**

Personal Accounts

Personal accounts may be further classified into three categories:

Natural Personal Account

An account related to any individual like David, George, Ram, or Shyam is called as a *Natural Personal Account.*

Artificial Personal Account

An account related to any artificial person like M/s ABC Ltd, M/s General Trading, M/s Reliance Industries, etc., is called as an *Artificial Personal Account.*

Representative Personal Account

Representative personal account represents a group of account. If there are a number of accounts of similar nature, it is better to group them like salary payable account, rent payable account, insurance prepaid account, interest receivable account, capital account and drawing account, etc.

Real Accounts

Every Business has some assets and every asset has an account. Thus, asset account is called a real account. There are two type of assets:

- **Tangible** assets are touchable assets such as plant, machinery, furniture, stock, cash, etc.
- **Intangible** assets are non-touchable assets such as goodwill, patent, copyrights, etc.
- Accounting treatment for both type of assets is same.

Nominal Accounts

Since this account does not represent any tangible asset, it is called nominal or fictitious account. All kinds of expense account, loss account, gain account or income accounts come under the category of nominal account. For example, rent account, salary account, electricity expenses account, interest income account, etc.

Rules of Debit and Credit under Double Entry System of Accounts

The following rules of debit and credit are called the golden rules of accounts:

Classification of Accounts	**Rules**	**Effect**
Personal Accounts	Debit the Receiver Credit the Giver	Debit = Credit

Real Accounts	Debit what Comes in Credit what Goes out	Debit = Credit
Nominal Accounts	Debit all the Expenses and Losses Credit all the Gains, Income and Profit	Debit = Credit

Journal

A book of original entry in which transactions are recorded in the order of their occurrence is called journal. Journal is a primary record of business transactions. Recording of transactions in the journal is known as journalizing and recorded transactions are called journal entries

In Short, Journal is a date-wise record of all the transactions with details of the accounts debited and credited and the amount of each transaction.

Format of Journal:

Journal

Date	Particulars	LF	Amount (Dr.)	Amount (Cr.)

Explanation:

1. Date: In the first column, the date of the transaction is entered. The year and the month is written only once, till they change. The sequence of the dates and months should be strictly maintained.

2. Particulars: Each transaction affects two accounts, out of which one account is debited and the other account is credited. The name of the account to be debited is written first, very near to the line of particulars column and the word **Dr.** is also written at the end of the particulars column. In the second line, the name of the account to be credited is written, starts with the word '**To**', a few space away from the margin in the particulars column to the make it distinct from the debit account.

3. Narration: After each entry, a brief explanation of the transaction together with necessary details is given in the particulars column with in brackets called **narration**. The words 'For' or 'Being' are used before starting to write down narration. Now, it is not necessary to use the word 'For' or 'Being'.

4. Ledger Folio (L.F): All entries from the journal are later posted into the ledger accounts. The page number or folio number of the Ledger, where the posting has been made from the Journal is recorded in the L.F column of the Journal. Till such time, this column remains blank.

5. Debit Amount: In this column, the amount of the account being debited is written.

6. Credit Amount: In this column, the amount of the account being credited is written.

Steps in Journalising

The process of analysing the business transactions under the heads of debit and credit and recording them in the Journal is called **Journalising**. An entry made in the journal is called a '**Journal Entry**'.

Step 1 Determine the two accounts which are involved in the transaction.

Step 2 Classify the above two accounts under Personal, Real or Nominal.

Step 3 Find out the rules of debit and credit for the above two accounts.

Step 4 Identify which account is to be debited and which account is to be credited.

Step 5 Record the date of transaction in the date column. The year and month is written once, till they change. The sequence of the dates and months should be strictly maintained.

Step 6 Enter the name of the account to be debited in the particulars column very close to the left hand side of the particulars column followed by the abbreviation Dr. in the same line. Against this, the amount to be debited is written in the debit amount column in the same line.

Step 7 Write the name of the account to be credited in the second line starts with the word '**To**' a few space away from the margin in the Particulars column. Against this, the amount to be credited is written in the credit amount column in the same line.

Step 8 Write the narration within brackets in the next line in the particulars column.

Step 9 Draw a line across the entire particulars column to separate one journal entry from the other.

Ledger:-

In the Journal, each transaction is dealt with separately. Therefore, it is not possible to know at a glance, the net result of many transactions. So, in order to ascertain the net effect of all the transactions relating to a particular account are collected at one place in the Ledger. A Ledger is a book which contains all the accounts whether personal, real or nominal, which are first entered in journal or special purpose subsidiary books.

According to **L.C. Cropper**, 'the book which contains a classified and permanent record of all the transactions of a business is called the Ledger'.

Features of ledger:-

1) Ledger is an account book that contains various accounts to which
2) Various business transactions of a business enterprise are posted.
3) It is a book of final entry because the transactions that are first entered in the journal or special purpose Books are finally posted in the ledger.
4) It is also called the Principal Book of Accounts.
5) In the ledger all types of accounts relating to assets, liabilities, capital, revenue and expenses are maintained.
6) It is a permanent record of business transactions classified into relevant accounts.
7) It is the 'reference book of accounting system and is used to classify and summarise transactions to facilitate the preparation of financial statements.

Format Ledger

Date	Particulars	J.F.	Amount	Date	Particulars	J.F.	Amount

Utility

Ledger is a principal or main book which contains all the accounts in which the transactions recorded in the books of original entry are transferred. Ledger is also called the **'Book of Final Entry'** or **'Book of Secondary Entry'**, because the transactions are finally incorporated in the Ledger. The following are the advantages of ledger.

i. Complete information at a glance:

All the transactions pertaining to an account are collected at one place in the ledger. By looking at the balance of that account, one can understand the collective effect of all such transactions at a glance.

ii. Arithmetical Accuracy

With the help of ledger balances, Trial balance can be prepared to know the arithmetical accuracy of accounts.

iii. Result of Business Operations

It facilitates the preparation of final accounts for ascertaining the operating result and the financial position of the business concern.

iv. Accounting information

The data supplied by various ledger accounts are summarised, analysed and interpreted for obtaining various accounting information

❖ **Important Points Regarding Ledger**

- ❖ Each side of a journal entry is posted in the same side of the ledger. It means the debit entry of a journal is posted in the debit side and vice-a-versa.
- ❖ Balance c/d refers to the balance carried down and balance b/d refers to the balance brought down.
- ❖ After posting in ledger, balancing of ledger is done. In the column named Total, the figure comes on the basis of '**whichever is higher'.** Means, if the total of debit side is Rs 10,000 and the total of credit is Rs 5,000, we write Rs 10,000 in the column named Total of both, the debit and the credit side.
- ❖ The difference of both sides (in this case, it is Rs 5,000) is written in the last row of the credit side as **'balance c/d'**. This balance is called the debit balance of account or vice-a-versa.
- ❖ All expenses and assets represent debit balance.
- ❖ All the income and liabilities represent credit balance including capital account.
- ❖ Debit balance of personal account represents **'Amount Receivable'.** This comes under the category of assets. For example debtors.
- ❖ Credit balance of personal accounts signifies '**Amount Payable'.** This comes under liabilities side and represents that we need to pay this amount which is credited due to goods, service, loan, or advance received.
- ❖ Debit side of real account means stock in hand or any kind of assets. Credit balance of Real account is not possible.
- ❖ Debit balance of nominal account means expenses of organization.
- ❖ Credit balance of nominal accounts means income earned.
- ❖ Debit balance of cash book means cash in hand.
- ❖ Debit side of Bank book means balance at bank.
- ❖ Credit balance of Bank book indicates **'Bank Overdraft'.**
- ❖ Debit and credit balances of nominal account (Expenses and income will be nil, because these balances get transferred to trading, and profit & loss account to arrive at profit and loss of the company.
- ❖ Balances of real and personal account appear in balance sheet of the company and to be carried forward to next accounting years.

Definition of Trail Balance:-

"**Trial balance** is a statement, prepared with the debit and credit balances of ledger accounts to test the arithmetical accuracy of the books" – **J.R. Batliboi**.

Trial balance provides us a comprehensive list of balances. With the help of that, we can draw financial reports of an organization. For example, the trading account can be analysed to ascertain the gross profit, the profit and loss account is analysed to ascertain the profit or Loss of that particular accounting year, and finally, the balance sheet of the concern is prepared to conclude the financial position of the firm

Objectives

The objectives of preparing a trial balance are:

i. To check the arithmetical accuracy of the ledger accounts.

ii. To locate the errors.

iii. To facilitate the preparation of final accounts.

Advantages

The advantages of the trial balance are

i. It helps to ascertain the arithmetical accuracy of the book-keeping work done during the period.

ii. It supplies in one place ready reference of all the balances of the ledger accounts.

iii. If any error is found out by preparing a trial balance, the same can be rectified before preparing final accounts.

iv. It is the basis on which final accounts are prepared.

Capital Transactions

The business transactions, which provide benefits or supply services to the business concern for more than one year or one operating cycle of the business, are known as capital transactions.

The transactions which relate to capital are again sub-divided into capital expenditure and capital receipt.

Capital Expenditure

Capital expenditure consists of those expenditures, the benefit of which is carried over to several accounting periods. In other words the benefit of which is not consumed within one accounting period. It is non-recurring in nature.

Characteristics

In other words, it refers to the expenditure, which may be

i. purchase of a fixed asset.

ii. not acquired for sale.

iii. it is non-recurring in nature.

iv. incurred to increase the operational efficiency of the business concern.

Examples

i. Expenses incurred in the acquisition of Land, Building, Machinery, Furniture, Car, Goodwill, Copyright, Trade Mark, Patent Right, etc.

ii. Expenses incurred for increasing the seating accommodation in a cinema hall.

iii. Expenses incurred for installation of fixed assets like wages paid for installing a plant.

iv. Expenses incurred for remodelling and reconditioning an existing asset like remodelling a building.

Capital Receipt

Capital receipt is one which is invested in the business for a long period. It includes long term loans obtained from others and any amount realised on sale of fixed assets. It is generally non-recurring in nature.

Characteristics

i. Amount is not received in the normal course of business.

ii. It is non-recurring in nature.

Examples

i. Capital introduced by the owner

ii. Borrowed loans

iii. Sale of fixed asset

Revenue Transactions

The business transactions, which provide benefits or supplies services to a business concern for an accounting period only, are known as revenue transactions. Revenue transactions can be Revenue Expenditure or Revenue Receipt.

Revenue Expenditure

Revenue expenditures consist of those expenditures, which are incurred in the normal course of business. They are incurred in order to maintain the existing earning capacity of the business. It helps in the upkeep of fixed assets. Generally it is recurring in nature.

Characteristics

i. It helps in maintaining the earning capacity of the business concern.

ii. It is recurring in nature.

Examples

i. Cost of goods purchased for resale. **ii.** Office and administrative expenses.

iii. Selling and distribution expenses. **iv**. Depreciation of fixed assets, interest on borrowings etc. **v.** Repairs, renewals, etc.

Revenue Receipt

Revenue receipt is the receipt of income which is earned during the normal course of business. It is recurring in nature.

Characteristics

i. It is received in the normal course of business.

ii. It is recurring in nature.

Examples

i. Sale of goods or services. **ii.** Commission and Discount received. **iii**. Dividend and interest received on investments etc.

Deferred Revenue Expenditure

A heavy revenue expenditure, the benefit of which may be extended over a number of years, and not for the current year alone is called deferred revenue expenditure. For example, a new firm may advertise very heavily in the beginning to capture a position in the market. The benefit of this advertisement campaign will last for quite a few years. It will be better to write off the expenditure in three or four years and not only in the first year.

Characteristics

i. Benefit is enjoyed for more than one year

ii. It is non-recurring in nature

Examples

i. Expenses incurred on research and development. **ii.** Abnormal loss arising out of fire or lightning (in case the asset has not been insured). **iii** Huge amount spent on advertisement.

Capital profit and Revenue profit

In order to find out the correct profit and the true financial position, there must be a clear distinction between capital profit and revenue profit.

Capital profits

Capital profit is the profit which arises not from the normal course of the business. Profit on sale of fixed asset is an example for capital profit.

Revenue profits

Revenue profit is the profit which arises from the normal course of the business. i.e, Net Profit – the excess of revenue receipts over revenue expenditures.

Capital loss and Revenue loss

In order to ascertain the loss incurred by a firm it is important to distinguish between capital losses and revenue losses.

Capital Losses

Capital losses are the losses which arise not from the normal course of business. Loss on sale of fixed asset is an example for capital loss.

Revenue Losses

Revenue losses are the losses that arise from the normal course of the business. In other words, 'net loss' – i.e., excess of revenue expenditures over revenue receipts.

Revenue expenditure, Capital Expenditure and Deferred revenue expenditure – Distinction

Basis of Distinction	**Capital Expenditure**	**Revenue Expenditure**	**Deferred Revenue Expenditure**
Period of benefit	Benefit is enjoyed beyond the accounting year lasts for a long time	Benefit is consumed during the current year only	Benefit enjoyed for more than one year
Purpose	Relates to the acquisition of fixed assets	Incurred for the purpose of generating revenue	Relates to the capturing or retaining the market
Nature of occurrence	Non-recurring in nature	Recurring in nature	Non-recurring in nature
Aim	Helps to increase the earning capacity	Helps to earn the existing revenue	Helps to increase the earning capacity of the business
Convertibility	Converted into cash	Cannot converted in cash	Cannot be converted in cash

A cash book is a special journal which is used to record all cash receipts and cash payments. The cash book is a book of original entry or prime entry since transactions are recorded for the first time from the source documents. The cash book is a ledger in the sense that it is designed in the form of a cash account and records cash receipts on the debit side and cash payments on the credit side. **Thus, the cash book is both a journal and a ledger**. **Cash Book will always show debit balance**, as cash payments can never exceed cash available. In short, cash book is a special journal which is used for recording all cash receipts and cash payments.

Advantages

1. **Saves time and labour:** When cash transactions are recorded in the journal a lot of time and labour will be involved. To avoid this all cash transactions are straight away recorded in the cash book which is in the form of a ledger.

2. **To know cash and bank balance:** It helps the proprietor to know the cash and bank balance at any point of time.

3. **Mistakes and frauds can be prevented:** Regular balancing of cash book reveals the balance of cash in hand. In case the cash book is maintained by business concern, it can avoid frauds. Discrepancies if any, can be identified and rectified.

4. **Effective cash management:** Cash book provides all information regarding total receipts and payments of the business concern at a particular period. So that, effective policy of cash management can be formulated.

7.3 Kinds of Cash Book

The various kinds of cash book from the point of view of uses may be as follow:

Single Column Cash Book

Single column cash book (simple cash book) has one amount column in each side. All cash receipts are recorded on the debit side and all cash payments on the credit side. In fact, this book is nothing but a Cash Account. Hence, there is no need to open cash account in the ledger. The format of a single column cash book is given below.

Format

Single Column Cash Book of ....

Debit Side Credit Side

Date	Particulars	R.N.	L.F.	Amount	Date	Particulars	V.N.	L.F.	Amount

Explanation:

i. **Date:** This column appears in both the debit and credit side. It records the date of receiving cash at debit side and paying cash at credit side.

ii. **Particulars:** This column is used at both debit and credit side. It records the names of parties (personal account), heads (nominal account) and items (real account) from whom payment has been received and to whom payment has been made.

iii. **Receipt Number (R.N):** This refers to the serial number of the cash receipt.

iv. **Voucher Number (V.N):** This refers to the serial number of the voucher for which payment is made.

v. **Ledger Folio (L.F):** This column is used in both the debit and credit side of cash book. The ledger page (folio) of every account in the cash book is recorded against it.

vi. **Amount:** This column appears in both sides of the cash book. The actual amount of cash receipt is recorded on the debit side. The actual payments are entered on the credit side.

Balancing: The cash book is balanced like any other account. The total of the receipt (debit side) column will always be greater than the total of the payment column (credit side). The difference will be written on the credit side as "By Balance c/d". In the beginning of the next period, to show the cash balance in hand, the balance amount is recorded in the debit side as "To balance b/d".

Double Column Cash Book

The most common double column cash books are

i. Cash book with discount and cash columns

ii. Cash book with cash and bank columns.

i. Cash Book with discount and cash columns

On either side of the single column cash book, another column is added to record discount allowed and discount received. The format is given below.

Format

Double Column Cash Book

(Cash book with Discount and Cash Column)

Date	Particulars	R.N.	L.F.	Discount allowed	Amount	Date	Particulars	V.N.	L.F.	Discount received	Amount

It should be noted that in the double column cash book, cash column is balanced like any other ledger account. But the discount column on each side is merely totalled. The total of the discount column on the debit side shows the total discount allowed to customers and is debited to Discount Allowed Account. The total of the discount column on the credit side shows total discount received and is credited to Discount Received Account.

i. Cash Book with Cash and Bank Columns

When bank transactions are more in number, it is advisable to open a cash book by providing a separate column on either side of the cash book to record the bank transactions therein. In such case, it is not necessary to open a separate Bank Account in the Ledger because the two columns in the cash book serve the purpose of Cash Account and Bank Account respectively. It is a combination of Cash Account and Bank Account. The format of this cash book is given below.

Date	Particulars	R.N.	L.F.	Cash	Bank	Date	Particulars	V.N.	L.F.	Cash	Bank

There are two amount columns on debit side one for cash receipts and the other for bank deposits (i.e., payment made into Bank Account). Similarly there are two amount columns on the credit side, one for payments in cash and the other for payments by cheques respectively.

Contra Entry: When an entry affect both cash and bank accounts it is called a **contra entry**. Contra in Latin means *opposite*. In contra entries both the debit and credit aspects of a transaction are recorded in the cash book itself.

Subsidiary Books

For a business having a large number of transactions it is practically impossible to write all transactions in one journal, because of the following limitations.

i. Periodical details of some important business transactions cannot be known, from the journal easily, e.g., monthly sales, monthly purchases.
ii. Such a system does not facilitate the installation of an internal check system since the journal can be handled by only one person.
iii. iii. The journal becomes bulky and voluminous.

Need: Moreover, transactions can be classified and grouped conveniently according to their nature, as some transactions are usually of repetitive in nature. Generally, **transactions are of two types: Cash and Credit**. Cash transactions can be grouped in one category whereas credit transactions can be grouped in another category. Thus, in practice, the main journal is sub-divided in such a way that a separate book is used for each category or group of transactions which are repetitive and sufficiently large in number. Each one of the subsidiary books is a special journal and a book of original or prime entry. Though the usual type of journal entries are not passed in these sub-divided journals, the double entry principles of accounting are strictly followed.

Kinds of Subsidiary Books: The number of subsidiary books may vary according to the requirements of each business. The following are the special purpose subsidiary books.

1) Purchases Book
2) Sales Book
3) Purchases Return Book
4) Sales Return Book
5) Bills Receivable Book
6) Bills Payable Book
7) Cash Book
8) Journal Proper

Purpose

i. **Purchases Book** records only credit purchases of goods by the trader.

ii. **Sales Book** is meant for entering only credit sales of goods by the trader.

iii. **Purchases Return Book** records the goods returned by the trader to suppliers.

iv. **Sales Return Book** deals with goods returned (out of previous sales) by the customers.

v. **Bills Receivable Book** records the receipts of bills (Bills Receivable).

vi. **Bills Payable Book** records the issue of bills (Bills Payable).

vii. **Cash Book** is used for recording only cash transactions i.e., receipts and payments of cash.

viii. **Journal Proper** is the journal which records the entries which cannot be entered in any of the above listed subsidiary books.

Advantages: The advantages of maintaining subsidiary books can be summarised as under:

i. **Division of Labour:** The division of journal, resulting in division of work, ensures more clerks working independently in recording original entries in the subsidiary books.

ii. **Efficiency:** The division of labour also helps the reduction in work load, saving in time and stationery. It also gives advantages of specialisation leading to efficiency.

iii. **Prevents Errors and Frauds:** The accounting work can be divided in such a manner that the work of one person is automatically checked by another person. With the use of internal check, the possibility of occurrence of errors and frauds may be avoided. For instance total credit sales for a month can be easily obtained from the Sales Book.

v. **Easy Postings:** Posting from the subsidiary books are made at convenient intervals depending upon the nature of the business.

The journal is sub divided in to the following subsidiary books

1. Cash Book: For recording all cash transactions

2. **Purchases Book**: For recording credit purchases of goods

3. **Sales Book**: For recording credit sales

4. **Purchase Returns Books.** For recording the goods returned by the trader to the suppliers

5. **Sales Returns Book:** For recording the goods returned to the trader by his

Customer

6. **Bills Receivable Books**: For recording all bills received by the trader from his customer

7. **Bills Payable Book**: For recording all the bills given (accepted) to suppliers

8**. Journal Proper**: For all transactions that do not find a place in any of the above books

Bank Reconciliation Statement

Meaning: This is a statement prepared so as to agree the bank balance as shown by the Pass Book with the Bank balance as shown by the Bank column of the Cash Book. Generally, this statement is prepared monthly In order to verify the accuracy of the banking transactions made by a trader with his Bank. These transactions are recorded by the bank in the Pass Book. Bank opens a separate account of each depositor in its ledger. All the banking transactions are recorded in the respective ledger account in the books of the Bank. Similarly the banking transactions are recorded by a trader in the bank column of the Cash Book or in a separate Bank Account In the ledger. That means every transaction with a Bank Is recorded in the Cash Book, as well as In the Pass Book. For example. If a trader has deposited Rs. 5.000 in the Bank, it will be recorded by the trader in the bank column appearing on the receipt side of the Cash Book or a Bank Account opened in the ledger will be debited. In the books of the Bank, credit will be given to customer's account I.e. a credit entry will be made in the Pass Book. That means a Bank Account in the books of a trader is debited, and a customer's account In the Pass Book will be credited with the same amount. As such, theoretically, both the balances must agree. But In practice, this does not happen. Bank balance as shown by Bank column of the Cash Book does not tally with the balance as shown by the Pass Book on a particular date. Therefore, it is necessary to find out the causes of difference between the two balances. Hence, the statement explaining the causes of disagreement between the two balances is drawn up.

Need of Bank Reconciliation Statement |

1. It helps to understand the actual bank balance position.
2. It facilitates detection of any mistakes in the Cash Book and in the Pass Book.
3. It helps to prevent frauds in recording the banking transactions.
4. It explains any delay in collection of cheques.

Reasons of Disagreement

The following are the reasons of disagreement between the Cash Book Bank balance and the Pass Book Bank balance:

1. Cheques issued but not presented for payment: A businessman issues cheques to his creditors in settlement of their accounts. The cheques issued are recorded in the bank column appearing on the payment side of the Cash Book immediately on the date of issue, but the Bank does not make a debit entry in the Pass Book. Entry in the Pass Book is made on presentation of the cheques by the creditors for payment. If creditors have not presented the cheques for payment the Bank will not make an entry in the Pass Book. Therefore, if we compare the Cash Book with the Pass Book, we will find that entry for Issue of cheques appears in the Cash Book but its corresponding entry does not appear in the Pass Book, and therefore, there will be a difference between the two balances.

2 **Cheques deposited in the Bank but not collected:** Cheques are received from customers from time to time in settlement of the account. The cheques received are sent to the bank for collection and the entry is made in the bank column on the receipt side of the Cash Book. But its corresponding entry does not appear in the Pass Book, as the Bank does not give credit immediately. Credit is given only after collecting the amount of the cheques. Therefore, the bank balance as shown by the Cash Book does not agree with the balance as shown by the Pass Book.

3. **Cheques received and entered in the Cash Book, but not deposited into bank for collection:** Cheques received from customers may be entered in the Bank column of the Cash Bank but the proprietor may forget to deposit the same into bank for collection. No entry is made by the bank in the Pass Book. In such a case the two balances will not agree.

4. **Cheques deposited into bank for collection but not entered in the Cash Book. :** Sometimes the customer might have received a cheque from the party and deposited the same into his bank for collection. But he might have failed to enter the cheque in the Cash Bank. The cheque might have been entered by the bank in the Pass Book and customer's ledger as it has been collected. In this case, the two balances will not tally.

5. **Direct Payment into the Customer's Bank A/c by other parties but not recorded in the Cash Book:** Sometimes a third party may deposit money in the Bank A/c of the customer directly but the intimation of the same may not be received by the customer. As a result corresponding entry of same may not be made in the Cash Book. As such these two balances will not agree.

6. Interest allowed and credited by the Bank: The Bank allows Interest on customer’s deposit account and gives credit in the Pass Book. The entry in the Cash Book is made after receiving intimation from the bank. If reconciliation statement is prepared before the receipt of such an intimation, there will be no corresponding entry in the Cash Book on its debit side. Hence, a difference will arise between the two balances.

7. Collection of dividend by the Bank: A businessman earns income. He may instruct the Bank to collect the amount of dividend on his shares. The bank makes a credit entry in the Pass Book Immediately after collection. But it may not be entered in the Cash Book Immediately unless an intimation to that effect is received from the Bank. Therefore, there will be disagreement between the two balances.

8. Interest charged or Bank charges or Commission debited in the Pass Book may not appear in the Cash Book due to lack of intimation from the Bank. Therefore, the balance as shown by the Pass Book will not agree with the balance as shown by the Cash Book.

9. Standing Instructions: A businessman may give standing instructions to the Bank for payment of insurance premium, shop rent, electricity charges etc. On making payment, the Bank passes a debit entry in the Pass Book, thereby reducing the customer's balance. The intimation of the same may not be received by the businessman. Therefore, it may not be recorded in the Cash Book. This will result in disagreement between the said balances.

10. Dishonor of Cheques: When the cheques deposited in the Bank are dishonoured, the Bank passes a debit entry in the Pass Book. The corresponding entry is passed in the Cash Book on receiving advice from the Bank. If a Bank Reconciliation Statement is prepared during this period, a difference will arise between the said two balances.

11. Errors: The balance as shown by the Cash Book will not agree with the balance as shown by the Pass Book, if certain errors are committed either by the accountant of a businessman or by the Bank clerk in recording the transactions.

Unit II: Final Accounts of Joint Stock Companies

Financial statements are the basic and formal annual reports through which the corporate management communicates financial information to its owners and various other external parties which include investors, tax authorities, government, employees, etc. These normally refer to: (a) the balance sheet (position statement) as at the end of accounting period, and (b) the statement of profit and loss of a company. Now-a-days, the cash flow statement is also taken as an integral component of the financial statements of a company.

Nature of Financial Statements

The following points explain the nature of financial statements:

1. *Recorded Facts:* Financial statements are prepared on the basis of facts in the form of cost data recorded in accounting books. The original cost or historical cost is the basis of recording transactions. The figures of various accounts such as cash in hand, cash at bank, trade receivables, fixed assets, etc., are taken as per the figures recorded in the accounting books. The assets purchased at different times and at different prices are put together and shown at costs. As these are not based on market prices, the financial statements do not show current financial condition of the concern.

2. *Accounting Conventions:* Certain accounting conventions are followed while preparing financial statements. The convention of valuing inventory at cost or market price, whichever is lower, is followed. The valuing of assets at cost *less* depreciation principle for balance sheet purposes is followed. The convention of materiality is followed in dealing with small items like pencils, pens, postage stamps, etc. These items are treated as expenditure in the year in which they are purchased even though they are assets in nature. The stationery is valued at cost and not on the principle of cost or market price, whichever is less. The use of accounting conventions makes financial statements comparable, simple and realistic.

3. *Postulates:* Financial statements are prepared on certain basic assumptions (pre-requisites) known as postulates such as going concern postulate, money measurement postulate, realization postulate, etc. Going concern postulate assumes that the enterprise is treated as a going concern and exists for a longer period of time. So the assets are shown on historical cost basis. Money measurement postulate assumes that the value of money will remain the same in different periods. Though there is drastic change in purchasing power of money, the assets purchased at different times will be shown at the amount paid for them. While, preparing statement of profit and loss the revenue is included in the sales of the year in which the sale

was undertaken even though the sale price may be received over a number of years. The assumption is known as realisation postulate.

4. *Personal Judgments:* Under more than one circumstance, facts and figures presented through financial statements are based on personal opinion, estimates and judgments. The depreciation is provided taking into consideration the useful economic life of fixed assets. Provisions for doubtful debts are made on estimates and personal judgments. In valuing inventory, cost or market value, whichever is less is being followed. While deciding either cost of inventory or market value of inventory, many personal judgments are to be made based on certain considerations. Personal opinion, judgments and estimates are made while preparing the financial statements to avoid any possibility of over statement of assets and liabilities, income and expenditure, keeping in mind the convention of conservatism. Thus, financial statements are the summarised reports of recorded facts and are prepared the following accounting concepts, conventions and requirements of Law.

Objectives of Financial Statements

To provide information about economic resources and obligations of a business: They are prepared to provide adequate, reliable and periodical information about economic resources and obligations of a business firm to investors and other external parties who have limited authority, ability or resources to obtain information.

2. *To provide information about the earning capacity of the business:* They are to provide useful financial information which can gainfully be utilised to predict, compare and evaluate the business firm's earning capacity.

3. *To provide information about cash flows:* They are to provide information useful to investors and creditors for predicting, comparing and evaluating, potential cash flows in terms of amount, timing and related uncertainties.

To judge effectiveness of management: They supply information useful for judging management's ability to utilise the resources of a business effectively.

5. *Information about activities of business affecting the society:* They have to report the activities of the business organisation affecting the society, which can be determined and described or measured and which are important in its social environment.

6. *Disclosing accounting policies:* These reports have to provide the significant policies, concepts followed in the process of accounting and changes taken up in them during the year to understand these statements in a better way.

Uses and Importance of Financial Statements

The various uses and importance of financial statements are as follows:

1. *Report the performance of Management :* Financial statements report the performance of the management to the shareholders. The gaps between the management performance and ownership expectations can be understood with the help of financial statements.

2. *Basis for fiscal policies:* The fiscal policies, particularly taxation policies of the government, are related with the financial performance of corporate undertakings. The financial statements provide basic input for industrial, taxation and other economic policies of the government.

3. *Basis for granting of credit:* Corporate undertakings have to borrow funds from banks and other financial institutions for different purposes. Credit granting institutions take decisions based on the financial performance of the undertakings. Thus, financial statements form the basis for granting of credit.

4. *Basis for prospective investors:* The investors include both short-term and long-term investors. Their prime considerations in their investment decisions are security and liquidity of their investment with reasonable profitability. Financial statements help the investors to assess long term and short-term solvency as well as the profitability of the concern.

5. *Guide to the value of the investment already made:* Shareholders of companies are interested in knowing the status, safety and return on their investment. They may also need information to take decision about continuation or discontinuation of their investment in the business. Financial statements provide information to the shareholders in taking such important decisions.

6. *Aids trade associations in helping their members:* Trade associations may analyse the financial statements for the purpose of providing service and protection to their members. They may develop standard ratios and design uniform system of accounts.

7. *Helps stock exchanges:* Financial statements help the stock exchanges to understand the extent of transparency in reporting on financial performance and enables them to call for required information to protect the interest of investors. The financial statements enable the Stock brokers to judge the financial position of different concerns and take decisions about the prices to be quoted.

Limitations of Financial Statements

1. *Do not reflect current situation:* Financial statements are prepared on the basis of historical cost. Since the purchasing power of money is changing,

the values of assets and liabilities shown in financial statement do not reflect current market situation.

2. *Assets may not realise:* Accounting is done on the basis of certain conventions. Some of the assets may not realise the stated values, if the liquidation is forced on the company. Assets shown in the balance sheet reflect merely unexpired or unamortised cost.

3. *Bias:* Financial statements are the outcome of recorded facts, accounting concepts and conventions used and personal judgments made in different situations by the accountants. Hence, bias may be observed in the results, and the financial position depicted in financial statements may not be realistic.

4. *Aggregate information:* Financial statements show aggregate information but not detailed information. Hence, they may not help the users in decision-making much.

5. *Vital information missing:* Balance sheet does not disclose information relating to loss of markets, and cessation of agreements, which have vital bearing on the enterprise.

6. *No qualitative information:* Financial statements contain only monetary information but not qualitative information like industrial relations, industrial climate, labour relations, quality of work, etc.

7. *They are only interim reports:* Statement of Profit and Loss discloses the profit/loss for a specified period. It does not give an idea about the earning capacity over time similarly, the financial position reflected in the balance sheet is true at that point of time, the likely change on a future date is not depicted.

Statutory Audit

The new legislation is focused on transparency and disclosure and gives audit its due recognition. In the new Act, attempt has been made to cover each aspect of corporate functioning under audit by prescribing various types of audits like internal audit and secretarial audit

Types of audits prescribed under the Companies Act, 2013.

1) Statutory Audit
2) Internal Audit
3) Secretarial Audit
4) Cost Audit

Statutory Audit

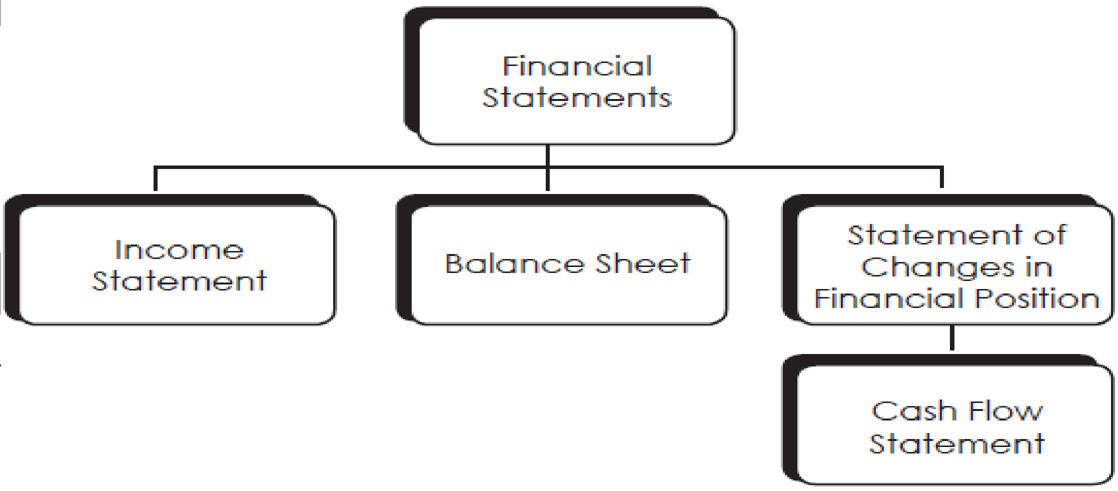
- Sections 139 to 147 under chapter X of the Act contain provisions regarding audit and auditors.

- Section 139 contains that at the first annual general meeting every company shall appoint an individual or firm as it auditor who will hold office from the conclusion of that meeting till the conclusion of the sixth annual general meeting.
- Section 141 contains that a person shall be eligible for appointment as an auditor of a company only if he is a chartered accountant and in case of a firm whereof majority of partners practicing in India are qualified for appointment as aforesaid may be appointed by its firm name to be auditor of a company.
- Section 143 which contains provisions regarding powers and duties of auditors contains that the statutory auditor shall make a report to the members of the company on the accounts and financial statements examined by him.

The main provisions regarding statutory audit are: ·

- Auditor will have access to books of accounts and vouchers etc. at all times and he can seek information from officers of the company as he may deem necessary.
- In his report he must state, besides other things, whether the financial statements represent a true and fair view of the state of company's affairs as at the end of the financial year.
- In case of any qualifications in the audit report, the reason for same must be stated in the report.
- Auditor is required to comply with Auditing Standards.
- In case auditor suspects any fraud, he must immediately report the same to the Central Government.

Component of Financial Statement



				at the end evious ng Period
			Rs.	Rs.
I	**Capital and liabilities**			

1	**Shareholders' Funds**			
	(a) Share Capital			
	(b) Reserves & Surplus			
	(c) Money Received against Share Warrants			
2	**Share Application money pending allotment**			
3	**Non-Current Liabilities**			
	(a) Long Term Borrowings			
	(b) DTL (Net)			
	(c) Other Long Term Liabilities			
	(d) Long Term Provisions			
4	**Current Liabilities**			
	(a) Short Term Borrowings			
	(b) Trade Payables			
	(c) Other Current Liabilities			
	(d) Short Term Provisions			
	Total of (1) To (4)			
II	**ASSETS**			
5	**Non-Current Assets**			
	(a) Fixed Assets			
	(i) Tangible Assets			
	(ii) Intangible Assets			
	(iii) Capital WIP			
	(iv) Intangible Assets under Development			
	(b) Non-Current Investments			
	(c) Deferred Tax Assets (Net)			
	(d) Long Term Loans & Advances			
	(e) Other Non-Current Assets			
	Total of (5)			
6	**Current Assets**			
	(a) Current Investments			
	(b) Inventories			
	(c) Trade Receivables			
	(d) Cash & Cash Equivalents			
	(e) Short Term Loans & Advances			
	(f) Other Current Assets			
	Total of (6)			
	Total of (5) To (6)			

Profit & Loss Statement for the year ended ____________

	Particulars	Note	Figure as at the end of Current Reporting Period	Figure as at the end of Previous Reporting Period
			Rs.	Rs.
I	**Revenue from Operations**			
II	Other Income			
III	**Total Revenue (I+II)**			
IV	**Expenses:**			
	Cost of Materials Consumed			
	Purchases of Stock-In-Trade			
	Changes in Inventories of Finished Goods / Work-in-Progress			
	Employee Benefits Expense			
	Finance Costs			
	Depreciation and Amortization Expense			
	Other Expenses			
	Total Expenses			
V	**Profit before Exceptional & Extraordinary Items and Tax (III – IV)**			
VI	**Exceptional Items**			
VII	Profit before Extraordinary Items and IAX (V-VI)			
VIII	Extraordinary Items			
IX	Profit before Tax (VII-VIII)			
X	Tax Expenses:			
	(1) Current Tax			
	(2) Deferred Tax			
XI	**Profit /(Loss) for the period from Continuing Operations (IX – X)**			
XII	Profit /(Loss) from Discontinuing Operations			
XIII	Tax Expense of Discontinuing Operations			
XIV	**Profit /(Loss) from Discontinuing Operations (After Tax) (XII-XIII)**			
XV	Profit / (Loss) for the period (XI + XIV)			
XVI	Earnings per Equity Share:			

	(1) Basic			
	(2) Diluted			

Schedule 1 for Shareholders Fund's

	Particular	Amount	Amount
	Share capital		
A	**Authorised share capital**		
	_______ equity shares of Rs._____ each		xxxx
	Issued capital & Subscribed and fully paid up capital	xxxx	
	Less: Calls-in-arrears	xxx	
	Add: Share forfeiture A/c	xx	xxxx
B	**Reserves and Surplus**		
	General Reserve	xxx	
	Capital Reserves	xxx	
	Capital Redemption Reserve	xxx	
	Securities Premium Reserve	xxx	
	Debenture Redemption Reserve	xxx	
	Revaluation Reserve	xxx	
	Other Reserves (specify the nature & purpose of each Reserve and the amount in respect thereof)	xxx	
	Surplus from Profit and Loss account	xxx	xxxx
C	**Money Received against Share Warrants**	xxx	xxx
	Total (A+B+C)		xxx

Schedule 2 for Share Application money pending allotment

Particular	Amount	Amount
Share Application money pending allotment	xxxx	

Schedule 3 for Non-Current Liabilities

No.	**Particular**	**Amount**	**Amount**
A	**Long Term Borrowings**		
	Debenture	xxxx	
	Bonds & Deposits,	xxxx	
	Terms Loans from Banks, and from Other Parties	xxxx	
	Deferred Payment Liabilities	xxxx	
	terms Loan secure and Unsecured loan	xxxx	
	Loans & Advances from Related Parties,	xxxx	xxxx
B	**Deferred Tax Assets (Net)**		
C	**Other long term liability**		
	Trade Payables	xxx	
	other	xxx	xxxx
D	**Long term provision**		
	Provision for Employee Benefits	xxx	xxxx
	Total (A+B+C+D)		xxxx

Schedule 4 for Current liabilities

No.	**Particular**	**Amount**	**Amount**
A	**Short Term Borrowings:**		
	Bank Overdraft	xxxx	
	Short Term Loans.	xxxx	xxxx
B	**Trade Payables**		
	Liability for Capital Goods Purchases:	xxxx	
	Liability under Contractual Obligations:	xxxx	xxxx
C	**Other Current Liabilities**		
	Outstanding Interest on Debenture	xxxx	
	Outstanding Salary/Wages Etc.	xxxx	
	Outstanding Managing Directors Remuneration	xxxx	
	Dividend Payable		xxxx
D	**Short Term Provisions**		
	Provision for Employee Benefits		
	Proposed Dividend	xxxx	

	Provisions for Tax & Any Other Short Term Provision	xxxx	xxxx
	Total (A+B+C+D)		xxx

Schedule 5 for Fixed Assets & Non Current Investment

No.	**Particular**	**Amount**	**Amount**
A	**Fixed Assets**		
	(I)Tangible Assets		
	Building	xxxx	
	(Less) Depreciation	xx	xxxx
	Plant & Machinery	xxxx	
	(Less) Depreciation	xx	xxxx
	Furniture & Fixture	xxxx	
	(Less) Depreciation	xx	xxxx
	Tools & Equipment	xxxx	
	(Less) Depreciation	xx	xxxx
	Total		xxxx
	(II) Intangible Assets		
	Goodwill	xxxx	
	Patents	xxxx	
	Trade Marks	xxxx	
	Technical Knowhow Etc.,	xxxx	xxxx
	(III) Capital WIP		xxxx
	(IV) Intangible Assets Under Development		xxxx
B	**Non-Current Investments**		
	Non-Current Investments shall be classified as Investments in		
	Property	xxxx	
	Equity Instruments,	xxxx	
	Preference Shares	xxxx	
	Government / Trust Securities,	xxxx	
	Debentures or Bonds,	xxxx	
	Mutual Funds,	xxxx	
	Partnership Firms Etc.,	xxxx	xxxx
C	**Deferred Tax Asset**		xxxx

D	**Long Term Loans And Advances**	xxxx	
	Long-term Trade Receivables	xxxx	xxxx
	Total (A+B+C+D)		xxxx

Schedule 6 for Current Assets

A	**Current Investment**	**Amount**	**Amount**
	Investments in Equity Instruments,	xxx	
	Investment in Preference Shares,	xxx	
	Investments in Government or Trust Securities,	xxx	
	Investments in Debentures or Bonds,	xxx	
	Investments in Mutual Funds,	xxx	
	Investments in Partnership Firms,	xxx	
	Other Investments (specify nature).	xxx	xxxx
B	**Inventories**		
	Raw materials,	xxx	
	Work In Progress,	xxx	
	Finished Goods,	xxx	
	Stock-in-Trade (in respect of goods acquired for Trading),	xxx	
	Stores and Spares,	xxx	
	Loose Tools,	xxx	
	Others (specify nature)	xxx	
	Goods-in-Transit	xxx	xxxx
C	**Trade Receivables**		
	Debtors	xxx	
	(Less) R.D.D	xx	xxxx
D	**Cash & Cash Equivalents**		
	Cash on Hand,	xxx	
	Balances with Banks,	xxx	
	Cheques, Drafts on Hand,	xxx	
E	**Short Term Loans And Advances**	xxx	xxxx
F	**Other Current Assets**		
	Current Assets that do not fit into any other Asset Categories.	xxx	xxxx
	Total (A+B+C+D+E+F)		**XXXX**

Schedule 7 for Revenue from operations

Particular	**Amount**	**Amount**
Sale of products	xxxx	
(Less) Excise Duty	xxx	
Sale (Net)		xxxx
Sale of services		xxxx
Other operating revenues		xxxx
Total Revenue from operations		xxxx

Schedule 8 for Other Income

Particular	**Amount**	**Amount**
Interest income (in case of a company other than a finance company),		xxxx
Dividend income,		xxxx
Net gain/loss on sale of investments,		xxxx
Other non-operating income (net of expenses directly attributable to such income).		xxxx
Total Other Income		xxxx

Schedule 9 for Expenses

	Particular	Amount	Amount
A	**Cost of Materials Consumed**		
	Opening Stock of Material and Stores	xxxx	
	(+) Purchases	xxx	xxxx
	(-) Closing Stock of Material and Stores		xxx
	(=) Cost of Materials Consumed		**xxxx**
B	**Changes in Inventories of Finished Goods / Work-in-Process**		
	Closing Stock: Work-in-Process	xxx	
	Finished Goods	xxx	xxxx
	(Less) Opening Stock: Work-in-Process	xxx	
	Finished Goods	xxx	xxxx
	Changes in Inventories of Finished Goods / Work-in-Process		xxxxx
	(Special Note : Opening Stock is more Debit to P & L Account)		
C	**Employee Benefits Expense**		
	Salary,	xxx	
	Salary & Wages,	xxx	
	Leave encashment	xxx	
	Staff welfare	xxx	
	M.D .Remuneration	xxx	
	Total Employee Benefits Expenses		xxxxx
D	**Finance Costs**		
	interest charges	xxx	
	Interest on Bank Loan	xxx	
	Interest on Dentures	xxx	
	Interest on Bank Overdraft		xxxxx
	Total Finance Costs		
E	**Depreciation and Amortization Expenses**		
	Depreciation on Fixed Assets	xxx	
	Amortization of intangible assets.	xxx	
	Total Depreciation and Amortization Expenses		xxxxx
F	**Other Expenses**		
	Administrative Expenses	xxx	
	Selling & Distribution Expenses	xxx	
	Total Other Expenses		xxxxx

Problem No.1:- From the following particulars furnished by Elegant Ltd., Prepare the Balance Sheet as on 31st March 2017 as required by Part-1 Revised schedule III of the Companies Act 2013

No.	Particulars	Debit	Credit
	Equity Share Capital (Face Value of Rs. 100 Each)		50,00,000
	Calls In Arrears	5,000	
	Land & Building	27,50,000	
	Plant & Machinery	26,25,000	
	Furniture	2,50,000	
	General Reserve		10,50,000
	Loan From State Financial Corporation		7,50,000
	Inventory		
	Raw Material	2,50,000	
	Finished Goods	10,00,000	
	Provision For Taxation		6,40,000
	Trade Receivables	10,00,000	
	Advances	2,13,500	
	Profit And Loss Account		4,33,500
	Cash in Hand	1,50,000	
	Cash at Bank	12,35,000	
	Unsecured Loan		6,05,000
	Trade Payables		10,00,000

Problem No.2:- From the given particulars of Shine and Bright Co. Ltd. as at March 31, 2018, Prepare Balance Sheet in accordance to the (revised) Schedule VI:

No.	Particulars	Amount	No.	Particulars	Amount
	Preliminary expenses	2,40,000		Bills Receivable	1,20,000
	Discount on Issue of shares	20,000		Inventory in trade	30,000
	Loose Tools	2,00,000		Provision for tax	12,000
	10% Debentures	1,40,000		Cash at bank	4,75,000
	Motor vehicles	1,35,000			

Problem No.3:- The following is the Trial Balance of M/s Finolex Limited as on 31.3.2017:

No.	Particulars	Debit	No.	Particulars	Credit
	Land at cost	2,20,000		Equity Capital (Shares of Rs. 10 each)	3,00,000
	Plant & Machinery at cost	7,70,000		10% Debentures	2,00,000
	Trade Receivables	96,000		General Reserve	1,30,000
	Inventories (31.3.16)	86,000		Profit & Loss A/c	72,000
	Bank	20,000		Securities Premium	40,000
	Adjusted Purchases	3,20,000		Sales	7,00,000
	Factory Expenses	60,000		Trade Payables	52,000
	Administration Expenses	30,000		Provision for Depreciation	1,72,000
	Selling Expenses	30,000		Dividend Receivables	4,000
	Debenture Interest	20,000			
	Interim Dividend Paid	18,000			
		16,70,000			**16,70,000**

Additional Information:

1) The value of closing stock at the end of the year amounted to Rs. 70,000
2) The Selling Expenses outstanding amounted to Rs.3,000
3) Prepaid Administration Expenses amounted to Rs. 3,000
4) The authorized share capital of the company is 40,000 shares of Rs. 10 each.

5) The company on the advice of independent valuer wishe to revalue the land at Rs. 3,60,000.
6) The board of Directors Proposed final dividend @ 10%.
7) Depreciation is to be provided on plant and machinery at 10% on cost.
8) Make a Provision for doubtful & Bad Debts @ 1%

You are required to Prepare Omega Limited's Balance Sheet as on 31.3.2017 and Statement of Profit and Loss for the year ended 31.3.2017 as per Revised Schedule VI. Ignore previous years' figures & taxation.

Problem No.4:- You are required to prepare financial statements from the following trial balance of M/s Nexus Ltd. for the year ended 31st March, 2018

M/s Nexus Ltd.

Trial Balance as at 31st March, 2018

No.	Particulars	Amount	No.	Particulars	Amount
	Inventory	6,80,000		Equity Shares Capital (Shares of Rs.10 each)	25,00,000
	Furniture	2,00,000		11% Debentures	5,00,000
	Discount	40,000		Bank loans	6,45,000
	Loan to Directors	80,000		Bills payable	1,25,000
	Advertisement	20,000		Creditors	1,56,000
	Bad debts	35,000		Sales	42,68,000
	Commission	1,20,000		Rent received	46,000
	Purchases	23,19,000		Transfer fees	10,000
	Plant & Machinery	8,60,000		Profit & Loss account	1,39,000
	Rentals	25,000		Depreciation Provision: Machinery	1,46,000
	Current account	45,000			
	Cash	8,000			
	Interest on bank loans	1,16,000			

	Preliminary expenses	10,000			
	Fixtures	3,00,000			
	Wages	9,00,000			
	Consumables	84,000			
	Freehold land	15,46,000			
	Tools & Equipment	2,45,000			
	Goodwill	2,65,000			
	Trade Receivables	2,87,000			
	Bills receivable	1,53,000			
	Dealer aids	21,000			
	Transit insurance	30,000			
	Trade expenses	72,000			
	Distribution freight	54,000			
	Debenture interest	20,000			
		85,35,000			**85,35,000**

Additional information:

1) Closing Inventory on 31-3-2018: Rs. 8,23,000.
2) Outstanding wages Rs. 90,000
3) Charge depreciation on plant and machinery 10%
4) Write off preliminary expenses Rs. 1000 & Goodwill Rs. 10,000
5) Make a provision for R.D.D. @5%

Problem No.5:- The following are the balances from the Ledger of Lake View Hotel Ltd., on 31st March 2018

No.	Share Capital - Credit Balance on 1st April, 2017	56,685
	Freehold Premises	46,800
	Furniture and Fittings	8,934
	Glass and China	1,101
	Linen	840

	Cutlery and Plate	390
	Rates, Taxes and Insurance	1,713
	Salaries	2,400
	Wages	4,305
	Inventory's on 31st March, 2017 :	2,376
	Purchases :	19,320
	Laundry Expenses	951
	Coal and Gas	2,160
	Electric Light	1,128
	General Expenses	1,710
	Sales — Wines Spirit; Beer,	10,068
	Sales — Minerals, Cigars and Cigarettes,	2,550
	Sales — Meals	23,829
	Sales — Rooms	9,375
	Sales — Fires in Bedrooms	582
	Sales — Washing Charges	219
	Repairs, Renewals, and Depreciation-	
	Premises	348
	Furniture and Fittings	660
	Glass and China	609
	Linen,	390
	Cutlery and Plate	207
	Cash Book - Debit Balances:	
	in Bank	7,500
	on hand	2,367
	Visitors Accounts unpaid	489
	Trade Payable	3,390

Additional Information :-

1) Inventory on 31st March, 2018 were valued at Rs. 2,370.

2) The Manager is entitled to a commission of 5% of the net profits after charging his commission.
3) The authorized share capital is 10,000 shares of Rs.10 each of which 5,700 shares were issued, the whole of the amount being called up. The final call on 210 shares @ Rs. 1.50 per share was unpaid; the directors forfeited these shares at their meeting held on 15th March, 2018
4) The tax liability is estimated at Rs. 4,300 and
5) The directors propose to declare a dividend at the rate of 6 percent.
Prepare the Final Accounts for presentation to the shareholders.

Problem No.6 The following balances have been extracted from the books of DOW Limited as on 31st March, 2018

No.	Particulars	Amount	No.	Particulars	Amount
	Cash in hand	3,800		Share Capital	90,000
	Cash at Bank	12,600		9% Debentures	30,000
	Bills Receivable	4,000		Trade Payables	29,000
	Investment	1,000		Profit and Loss A/c	2,000
	Security Deposit	400		Secured Loan from bank against Inventory	50,000
	Advances	8,500		Gross Profit	1,75,000
	trade Receivables	75,000		Share Suspense	3,000
	Land and Buildings	1,05,000		Liabilities for expenses	12,000
	Furniture	4,500		Sale of Furniture	300
	Motor Car	25,000		Bills Payable	3,100
	Closing Inventory	95,000		Miscellaneous Receipts	425
	Establishment expenses	35,200			
	Repairs and renewals	2,600			
	Motor Car Expenses	4,200			
	Travelling and Conveyance	1,600			
	Printing and Stationery	900			
	Telephone	1,200			
	Debenture Interest	2,025			

	Commission on sales	3,200			
	Advertisement	3,500			
	Managing Director's remuneration	3,600			
	Directors fees	2,000			
		3,94,825			**3,94,825**

The following further particulars are available:

1) Amount of share capital has been arrived at as follows
   9,200 equity shares of Rs. 10 each, fully called up 92,000
   Less : Calls-in-arrear @ Rs. 2 on 1,000 shares (2,000)
   90,000
2) The Profit and Loss Account balance has been arrived at after charging ` 5,000 on account of short provision of taxation for the earlier year.
3) Cost of land Rs. 30,000 is included in the amount of land and buildings.
4) Trade receivable, which are all unsecured and considered goods, include Rs. 10,000 due for more than six months.
5) Advertisement charges include materials of Rs. 1,500.
6) Amounts of Rs. 2,000 and Rs. 1,200 debited to purchases and wages respectively, were for making new furniture during the year.
7) Investment represents purchase of 200 equity shares of Rs 10 each, Rs 5 per share called and paid up.
8) Charge depreciation on the closing written down amount of -

Fixed Assets	Original cost	Depreciation @
Buildings	1,00,000	2.5%
Furniture	9,000	10%
Motor Car	35,000	20%

9) Provision for income-tax is to be made, for the year, of Rs.65,000.
10) The following appropriations have been proposed by the Board of Directors out of the profit for the year -
    (a) Transfer of ` 20,000 to General Reserve.
    (b) Dividend of 12% on the paid-up capital.
11) Debentures were issued two years back, and are not secured.

You are required to prepare the Statement of Profit and Loss for the year ended 31st March, 2018 and the Balance as on that date. Ignore previous year's figures.

Problem No.7 You are required to prepare a Statement of Profit and Loss and Balance Sheet from the following Trial Balance extracted from the books of the Sun and Sand Company Ltd., on 31st March, 2018

No.	Particulars	Dr.	Cr.

	Authorised Capital-divided into :-		
	5,000 6% Preference Shares of Rs.100 each		5,00,000
	10,000 equity Shares of Rs. 100 each		10,00,000
			15,00,000
	Subscribed Capital -		-
	5,000 6% Preference Shares of Rs. 100 each		5,00,000
	Equity Capital 8000 equity Shares of Rs. 100 each		8,00,000
	Purchases	82,000	
	Wages and Salaries	28,300	
	Rent, Rates and Taxes	9,650	
	Sales		1,83,200
	Coal and Firewood	3,290	
	Carriage and Colleage	810	
	Sundry Expenses	5,840	
	Advertising	8,360	
	Repairs	4,250	
	Interest received		3,300
	Freehold Land and Building	8,50,000	
	Furniture and Fittings	86,300	
	Inventory 1st April, 2017	18,060	
	Cash in hand	2,200	
	Cash with Bankers	76,380	
	Preliminary and formation expenses	8,000	
	2,000 Debentures of Rs. 100 each (6%)		2,00,000
	Profit and Loss Account		41,500
	Trade Payable		42,000
	Trade Receivable	19,260	
	Investments	2,72,300	
	Goodwill at cost	5,00,000	
	General Reserve		2,00,000
		19,75,000	19,75,000

Additional Information

1) Wages and Salaries Outstanding Rs. 1,700 and Rent, Rates and Taxes Rs. 350
2) Inventory on 31st March, 2018 Rs. 38,900
3) Depreciation on Furniture and Fittings @ 5% p.a. : Land and Building @ 2% p.a.
4) The Directors propose a dividend of 8% on equity shares.
5) Interest on investment is receivable Rs. 1,700.
6) Write off Preliminary and formation expenses & Goodwill @ 10%

You are required to prepare the Statement of Profit and Loss for the year ended 31st March, 2018 and the Balance as on that date.

Problem No 8. From the following particulars furnished by Metronic Company Ltd., Prepare the Balance Sheet as at 31st March, 2018 as required by Part I, Schedule VI of the Companies Act.

No.	Particulars	Debit	Credit
	Equity Capital (Face value of Rs. 100)		10,00,000
	Calls in Arrears	1,000	
	Land	2,00,000	
	Building	3,50,000	
	Plant and Machinery	5,25,000	
	Furniture	50,000	
	General Reserve		2,10,000
	Loan from State Financial Corporation		1,50,000
	Inventory :		
	Finished Goods	2,00,000	
	Raw Materials	50,000	
	Provision for Taxation		68,000
	Trade Receivable	2,00,000	
	Advances from Customer	42,700	
	Proposed Dividend		60,000
	Profit and Loss Account		1,00,000
	Cash Balance	30,000	

	Cash at Bank	2,47,000	
	Preliminary Expenses	13,300	
	Loans (Unsecured)	1,21,000	1,21,000
	Trade Payable (For Goods and Expenses)		2,00,000
		19,09,000	**19,09,000**

The following additional information is also provided :

(1) 2,000 equity shares were issued for consideration other than cash.

(2) Trade Receivable of Rs. 52,000 are due for more than six months.

(3) The cost of assets on 1st April 2017 were :

a. Building 4,00,000

b. Plant and Machinery 7,00,000

c. Furniture 62,500

(4) The value of closing at the end of the year is Rs Raw Material Rs. 5000 & Finished Goods Rs. 20,000.

(5) Transfer to General Reserve Rs. 40,000

You are required to prepare the Statement of Profit and Loss for the year ended 31st March, 2018 and the Balance as on that date. Ignore previous year's figures

Problem No. 9. You are required to prepare a Statement of Profit and Loss and Balance Sheet from the following Trial Balance extracted from the books of the M/s Apollo Company Ltd., on 31st March, 2018

No.	**Particulars**	**Dr.**	**Cr.**
	Equity Capital (Face Value of Rs. 100)		40,00,000
	General Reserve		24,25,000
	Land & Building	4,500,000	
	Plant & Machinery	18,00,000	
	Other Tangible Assets	2,00,000	-
	Intangible Fixed Assets	5,00,000	
	Investment In Share & Debenture -Non Current	9,50,000	
	Investment In Share & Debenture - Current	7,00,000	
	Loan From SFC for Fixed Assets -Long Term		4,00,000
	12% Debenture		8,00,000
	Borrowing For Working Capital: Short Term		10,00,000

	Opening Inventory : Raw Material	9,00,000	
	Opening Inventory : Finished Good	7,00,000	
	Trade Receivable	4,00,000	
	Cash Balance	2,00,000	
	Other Current Assets	1,50,000	
	Trade Payable		3,00,000
	Other Current Liability		2,00,000
	Provision For Tax		2,00,000
	Proposed Dividend		5,00,000
	Provision For Employee Retirement Benefit		7,00,000
	Long Term Liability		4,00,000
	Purchase of Raw Material	9,000,000	
	Purchase of Finished Good	1,000,000	
	Salary And Wages	20,00,000	
	Power And Electricity	2,00,000	
	Repairs And Maintenance	1,00,000	
	Commission on Sales	2,00,000	
	Insurance	2,50,000	
	Depreciation & Amortization Expenses	7,30,000	
	Interest on Debenture	96,000	
	Interest on Other Borrowing	1,24,000	
	Sales		1,50,00,000
	Interest & Dividend received on Investment		2,50,000
	Exceptional Item : Profit on Sale of Fixed Assets		1,00,000
	Deferred Tax Assets	1,50,000	
	Income Tax	10,00,000	
	Loan & Advances for Fixed Assets	3,00,000	
	Advances to Customer	1,25,000	
		2,62,75,00	2,62,75,000

		0	

Additional Information

1) Closing stock of raw material valued at Rs. 6,00,000 and finished good Rs. 10,00,000
2) Salary and wages outstanding Rs. 50,000 & Power And Electricity Rs. 20,000
3) Interest & Dividend on investment is outstanding Rs. 1,50,000.
4) Prepaid Insurance Rs. 50,000.

Unit III: Interpretation of Financial Statements: Cash Flow Analysis

Cash Flow Statement deals with flow of cash which includes cash equivalents as well as cash. This statement is additional information to the users of Financial Statements. The statement shows the incoming and outgoing of cash. The statement assesses the capability of the enterprise to generate cash and utilize it.

Thus a Cash-Flow statement may be defined as a summary of receipts and disbursements of cash for a particular period of time. It also explains reasons for the changes in cash position of the firm. Cash flows are cash inflows and outflows. Transactions which increase the cash position of the entity are called as inflows of cash and those which decrease the cash position as outflows of cash. Cash flow Statement traces the various sources which bring in cash such as cash from operating activities, sale of current and fixed assets, issue of share capital and debentures etc. and applications which cause outflow of cash such as loss from operations, purchase of current and fixed assets, redemption of debentures, preference shares and other long-term debt for cash. In short, a cash flow statement shows the cash receipts and disbursements during a certain period.

In short we can say, Cash flow statement is a summarized statement showing sources of Cash Inflow and applications of cash outflows of an enterprise during a particular period of time.

Features:

The significant features are:

(i) Cash Flow Statement is very dynamic in character since it records the investment of cash from beginning of the period to the end of the period.

(ii) It is periodical statement as it covers a particular period.

(iii) This statement does not recognize matching principles.

The statement of cash flow serves a number of objectives which are as follows:

1) Cash flow statement aims at highlighting the cash generated from operating activities.

2) Cash flow statement helps in planning the repayment of loan schedule and replacement of fixed assets, etc.

3) Cash is the centre of all financial decisions. It is used as the basis for the projection of future investing and financing plans of the enterprise.

4) Cash flow statement helps to ascertain the liquid position of the firm in a better manner. Banks and financial institutions mostly prefer cash flow statement to analyse liquidity of the borrowing firm.

5) Cash flow Statement helps in efficient and effective management of cash.

6) The management generally looks into cash flow statements to understand the internally generated cash which is best utilised for payment of dividends.

7) Cash Flow Statement based on AS-3 (revised) presents separately cash generated and used in operating, investing and financing activities.

8) It is very useful in the evaluation of cash position of a firm.

Cash and relevant terms as per AS-3 (revised)

As per AS-3 (revised) issued by the Accounting Standards Board

1. (a) Cash fund : Cash Fund includes:

(i) Cash in hand

(ii) Demand deposits with banks, and

(iii) Cash equivalents.

(b) Cash equivalents are short-term, highly liquid investments, readily convertible into cash and which are subject to insignificant risk of changes in values.

Presentation of Cash Flow:

Cash Flow Statement explains cash movements under three different heads, namely

Operating activities are the principal revenue - producing activities of the enterprise and other activities that are not investing and financing. Operating activities include all transactions that are not defined as investing or financing. Operating activities generally involve producing and delivering goods and providing services. •

Cash flow from operating activities;

Elements of operating cash flow

Given below are elements of operating cash flow:

- Cash receipts from sale of goods and rendering services.
- Cash receipts from royalty, fees, commissions and other revenue.
- Cash payments to suppliers for goods and services.
- Cash payments to and on behalf of employees.
- Cash receipts and cash payments by an insurance enterprise for premiums and claims, annuities and other policy benefits.
- Cash payments and refunds of income taxes unless these are specifically identified as cash flow from financing or investment.
- Cash receipts and payments relating to contracts held for dealing or trading purposes.

• Cash flow arising from dealing in securities when an enterprise holds securities for such purpose.

• Cash advances and loans made by financial institutions including all contracts held for trading purposes which may range from sale license, export-import quota, any other operating contract. This may not necessarily be a contract relating to derivative instruments.

Investment activities are the acquisition and disposal of long term assets and other investments not included in cash equivalents.

Elements of cash flow from investment activities

Given below are eight elements of investment cash flow:

• Cash payments for acquisition of fixed assets including intangibles.

• Cash receipts from disposal of fixed assets.

• Cash payments to acquire shares, warrants or debt instruments of other enterprises and Interests in joint venture. This does not include an item covered in cash equivalents and items held for dealing or trading purposes.

• Cash receipts from disposal of shares, warrants or debt instruments of other enterprises and interests in joint venture. This does not include an item covered in cash equivalents and items held for dealing or trading purposes.

• Cash advances and loans made to third parties. This does not include loans and advances made by financial institutions as these fall under operating cash flow.

• Cash receipts from repayments of advances and loans made to third parties. This does not include.

• Cash payments for future, forward, option and swap contracts. This does not include contracts held for dealing or trading purposes or contracts which as classified as financing activities.

Financing activities are activities that result in changes in the size and composition of the owners' capital (including preference share capital in the case of a company) and borrowings of the enterprise.

Elements of cash flow from financing activities

Given below are five elements illustrated cash flow from financing activities:

- ❖ Cash proceeds from issuing shares or other equity instruments.
- ❖ Cash payments to owners to acquire or redeem the enterprise's shares.
- ❖ Cash proceeds from issuing debentures, loans, notes, bonds, mortgages, and other short term and long term borrowings.
- ❖ Cash repayments of amounts borrowed.
- ❖ Cash payments by a lease for the reduction of the outstanding liability relating to a finance lease

Important Points for Students:-

- ❖ Order followed for presenting the cash flow is to show operating activities, followed by investing activities and financing activities.
- ❖ The net cash flow from an activity operating investing and financing can be positive or negative. Positive cash flow mean net inflow. i.e., receipts exceed payments. Negative cash flow means net outflow i.e., payments exceed receipts.
- ❖ The sum of net inflows or outflows of all the activities results in an increase or decrease in cash balances, which is reconciled with the opening and closing balances of cash.

Other Items: In addition to the cash flows described, AS-3 (Revised) also deals with certain other items as outlined below: —

(a) Interest and Dividends: Treatment of cash flows from interest and dividends can be described under two heads:

(i) In case of a financial enterprise, cash flows arising from interest paid and interest and dividends received should be classified as cash flows from operating activities. Dividends paid should be classified as cash flows from financing activities.

(ii) In the case of other enterprises, cash flows arising from interest and dividends paid should be classified as cash flows from financing activities while interest and dividends received should be classified as cash flows from investing activities.

In all cases, cash flows from interest and dividends received and paid should each be disclosed separately. Also, the total amount of interest paid during the period is disclosed in the cash flow statement whether it has been recognised as an expense in the statement of profit and loss or capitalised in accordance with AS-10: Accounting for Fixed Assets.

(b) Taxes on Income: Cash flows arising from taxes on income should be separately disclosed and should be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities.

For example, capital gain tax on the sale of land and building is identifiable with the investing activities and hence in the cash flow statement, it should be shown as outflow from investing activities.

(c) Extraordinary Items: The cash flows associated with extraordinary items should be classified as arising from operating, investing or financing activities as appropriate and separately disclosed, winning of a law suit or a lottery and receipt of claim from an insurance company are examples of extraordinary items.

These disclosures are in addition to the separate disclosures of the nature and amount of extraordinary items required by AS 5, Net Profit or Loss for the Period, Prior Period Items, and Changes in Accounting Policies.

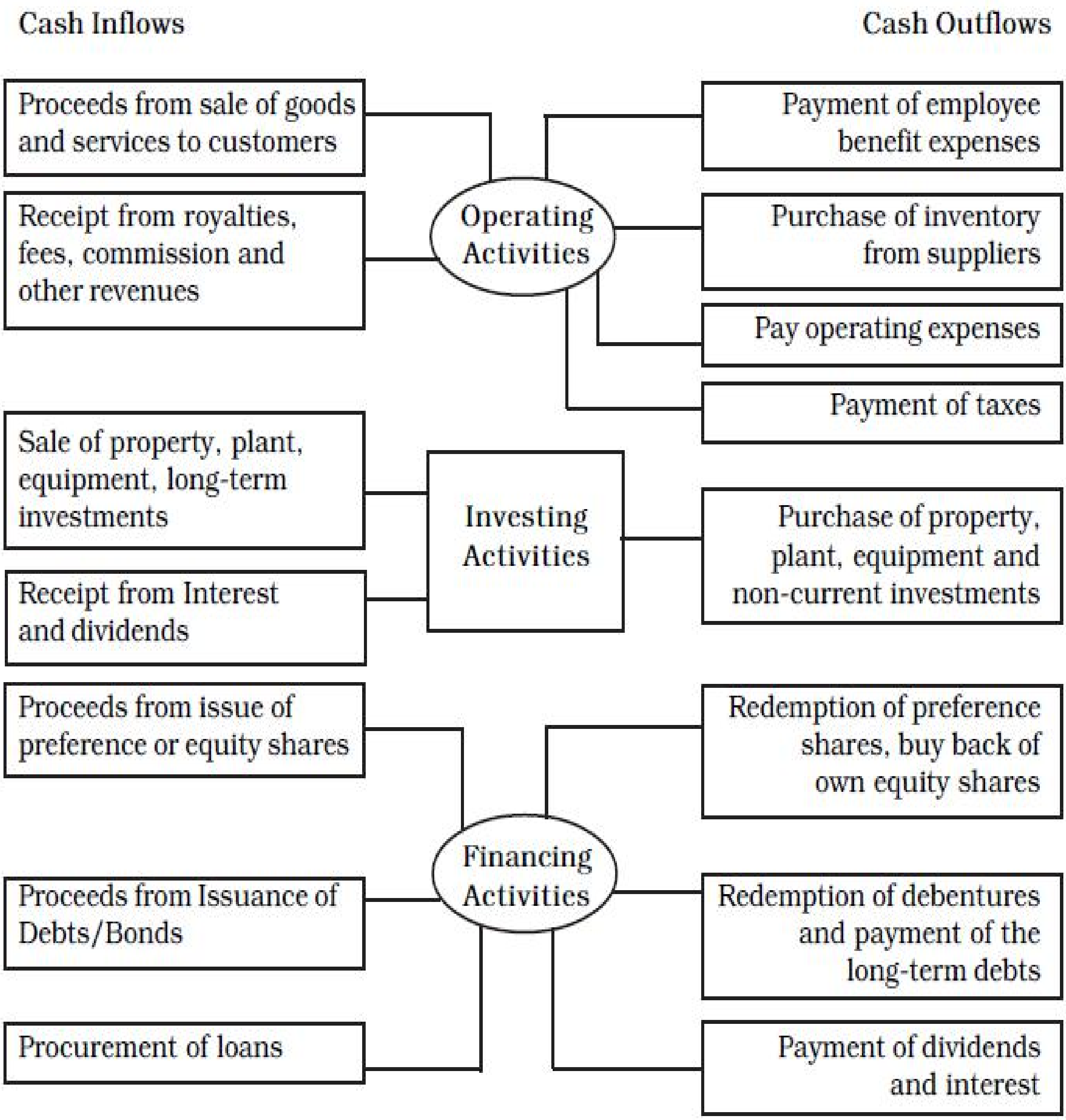
(d) Non-cash Transactions: Transactions which do not involve inflow or outflow of cash or cash equivalents are, for obvious reasons, excluded from a cash flow statement. But significant non-cash investing and financing transactions should be reported in a separate schedule to the cash flow statement.

Examples of non-cash transactions are:

(i) The acquisition of an enterprise by means of issue of shares;

(ii) The acquisition of a fixed asset, say machinery, on credit; and

(iii) The conversion of convertible debentures into equity shares.



Proforma of Cash Flow Statement as per AS-3

Cash flow Statement of ——————for the period ended ——————

	Particulars	Rs.	Rs.
	Cash Flow From Operating Activities:-		
	Net profit before tax and extraordinary items		xxx
	Adjustment for :-		
	Depreciation	xxx	
	interest income	xxx	
	Dividend income	xxx	
	Interest expenses	xxx	
	Foreign exchange loss	xxx	xxx

	Operating profit before working capital changes		xxx
	Adjustment for changes in current assets and current liabilities:-		
(+)	a) increase in current liabilities	xxx	
	b) decrease in current assets	xxx	
(-)	a) decrease in current liabilities	xxx	
	b) increase in current assets	xxx	xxx
	Income tax paid		xxx
	Cash flow before extraordinary items		xxx
	Extraordinary items		xxx
	Net Cash From Operating Activities		xxx
	Net cash flow from investing activities:-		
	Purchase of fixed assets	xxx	
	Proceeds from sale of fixed assets	xxx	
	Interest and dividend received	xxx	xxx
	Net cash from investing activities		xxx
	Net cash flow from financing activities:-		
	Proceeds from issue of shares/ Debentures	xxx	
	Proceeds from long term borrowings	xxx	
	Re-payment of long term borrowings	xxx	
	Interest paid	xxx	
	Dividend paid	xxx	xxx
	Net cash from investing activities		xxx
	Net increase or decrease in cash and cash equivalents:-		
	cash and cash equivalents at the beginning of the period		xxx
	cash and cash equivalents at the end of the period		xxx

Cash Flow Statement Numerical

Problem No.1 From the following Balance Sheets of XYL Limited, Prepare Cash Flow Statement:

	Particulars	Note No.	31.03.2018	31.03.2017
	I) Equity and Liabilities :		Amount	Amount
	Shareholder's Funds :	1		
	a) Share Capital		5,00,000	4,50,000
	b) Reserve & Surplus		1,18,000	70,000
	Current Liabilities			
	a) Trade Payables		99,000	75,000
	b) Short Term Provisions	2	1,00,000	82,000
	Total		**8,17,000**	**6,77,000**
	II. Assets :			
	Non-Current Assets :			
	(a) Fixed Assets			
	(i) Tangible Assets	3	3,70,000	2,80,000
	(ii) Intangible Assets	4	90,000	1,15,000
	(2) Current Assets :			
	(a) Inventory		1,09,000	77,000
	(b) Trade Receivables		2,30,000	1,80,000
	(c) Cash & Cash Equivalents		18,000	25,000
	Total		**8,17,000**	**6,77,000**

Notes:

Note No.	Particulars	31.03.2018 Amount	31.03.2017 Amount
1	**Reserve & Surplus:**		
	General Reserve	70,000	40,000
	Profit & Loss Balance	48,000	30,000
	Total	1,18,000	70,000
2	**Short Term Provisions:**		
	Provision for Taxation	50,000	40,000
	Proposed Dividend	50,000	42,000
	Total	1,00,000	82,000
3	**Tangible Assets :**		
	Land & Building	1,70,000	2,00,000
	Plant	2,00,000	80,000

	Total	3,70,000	2,80,000
4	**Intangible Assets :** Goodwill	90,000	1,15,000
	Total	90,000	1,15,000

Additional Information:-

a) Depreciation of Rs. 10,000 & Rs. 20,000 has been charged on plant, land & Building respectively.
b) An interim dividend of Rs 20,000 has been paid.
c) Income Tax of Rs 35,000 has been paid.
d) Rent Received during the year Rs 10,000

Problem No.2 From the following Balance Sheets of M/s KTI ltd., Prepare cash flow statement.:

Balance Sheet As at 31.03.2018 and 31.03.2017

	Particulars	**Note No.**	**31.03.2018**	**31.03.2017**
	I. Equity and Liabilities :		Amount	Amount
	(1) Shareholder's Funds :	1		
	a) Share Capital		1,00,000	80,000
	b)Reserve & Surplus		6,400	6,000
	(2)**Non-Current Liabilities**			
	Long- term Borrowing	2	14,000	12,000
	(3)Current Liabilities			
	a) Short Term Borrowing	3	13,600	25,000
	b Trade Payables		20,000	24,000
	c) Short Term Provisions	4	20,000	16,000
	d) Other Current Liabilities	5	2,000	-
	Total		**1,76,000**	**1,63,000**
	I. Assets :			
	(1) Non-Current Assets :			
	Fixed Assets	6	50,000	60,000
	(2) Current Assets :			
	a) Inventories		70,000	60,000
	b) Trade Receivables		48,000	40,000
	c) Cash & Cash Equivalents		7,000	2,400
	d) Prepaid Expenses		1,000	600
	Total		**1,76,000**	**1,63,000**

Notes:

Note No.	Particulars	31.03.2018 Amount	31.03.2017 Amount
1	**Reserve & Surplus:** General Reserve Profit & Loss Balance	 4,000 2,400	 4,000 2,000
	Total	**6,400**	**6,000**
2	**Long Term Borrowing :** 15% Debenture	 14,000	 12,000
	Total	**14,000**	**12,000**
3	**Short Term Borrowing :** Cash Credit	 13,600	 25,000
	Total	**13,600**	**25,000**
3	**Short Term Provisions:** Provision for Taxation Proposed Dividend	 8,400 11,600	 6,000 10,000
	Total	**20,000**	**16,000**
	Other Current Liabilities : Dividend Payable	 2,000	 -
4	**Fixed Assets :** Less :- Accumulated Depreciation	80,000 30,000	82,000 22,000
	Total	**50,000**	**60,000**

Additional Information:-

a) Provision for tax made Rs 9,400

b) Fixed Asset sold for Rs 10,000, their cost Rs 20,000 and accumulated depreciation till date of sale is Rs 6,000

c) An interim dividend paid during the year Rs 9,000

Problem No.3 You are required to prepare a Cash- Flow statement (as per AS-3) for the year 2017-18 from the following Balance Sheets :

Balance Sheets of Janakhi India Ltd.

31st March, 2018

Particulars	Note No.	31.03.2018	31.03.2017
I. Equity and Liabilities :		Amount	Amount
(1) Shareholder's Funds :			
a) Share Capital (Equity Share Capital)		3,00,000	2,00,000
b) Reserve & Surplus (Statement of P&L a/c)		1,20,000	70,000
(2) Non-Current Liabilities			
a) Long- term Borrowing (8% Debenture)		1,50,000	1,20,000
(3) Current Liabilities			
a) Short Term Borrowing (Bank Overdraft)		19,000	5,000
b) Trade Payables (Creditors)		31,000	20,000
c) Short Term Provisions		1,32,000	1,21,600
Total		**7,52,000**	**5,36,600**
I. Assets :			
(1) Non-Current Assets :			
a) Fixed Assets			
Tangible	2	2,04,200	1,83,000
b) Non-Current Investment		1,30,000	1,20,000
(2) Current Assets :			
a) Inventories		1,41,500	1,25,000
b) Trade Receivables		64,600	64,500
c) Cash & Bank Balances (Cash at Bank)		2,11,700	44,100
Total		**7,52,000**	**5,36,600**

Note No.	Particulars	31.03.2018 Amount	31.03.2017 Amount
1	**Short Term Provisions:**		
	Proposed Dividend	80,000	60,000
	Provision for Taxation	50,000	60,000
	Provision for Doubtful Debts	2,000	1,600
	Total	1,32,000	1,21,600
3	**Fixed Assets (Tangible)**		
	Plant & Machinery	2,43,000	2,23,000
	Less:- Accumulated Depreciation	(38,800)	(40,000)

	Total	2,04,200	1,83,000

Additional Information:-During the year 2017-18:

1) A part of Machinery was sold for Rs 21,000 a profit of Rs 4,000.
2) The company charged Rs 3,000 as depreciation on its Plant & Machinery.
3) New Debenture were issued on 31st March,2018 at a discount of 10%
4) Interest of Rs 9,000 was paid on Debenture.

Problem No.4 From the following Balance Sheets of M/s Zee Ltd , Prepare its Cash Flow Statement for the year 2017-18 (As per AS- 3)

	Particulars	Note No.	2017-18	2016-17
I.	**Equity and Liabilities :**		Amount	Amount
	(1) Shareholder's Funds :			
	a) Share Capital		33,00,000	32,00,000
	b) Reserve & Surplus	1	5,00,000	4,00,000
	(2) Non-Current Liabilities			
	Long- term Borrowing	2	16,00,000	15,00,000
	(3) Current Liabilities			
	a) Trade Payables (Creditors)		3,00,000	5,00,000
	b) Short Term Provisions		50,000	40,000
	Total		**57,50,000**	**56,40,000**
II.	**Assets :**			
	(1) Non-Current Assets :			
	a) Fixed Assets			
i)	Tangible	4	39,50,000	34,60,000
ii)	Intangible	5	50,000	40,000
	b) Non-Current Investment		6,00,000	6,00,000
	(2) Current Assets :			
	a) Current Investment	6	10,000	30,000
	b) Inventories		50,000	40,000
	c) Trade Receivables		6,00,000	8,00,000
	d) Cash & Bank Balances		4,90,000	6,70,000
	Total		**57,50,000**	**56,40,000**

Note No.	**Particulars**	**2017-18 Amount**	**2016-17 Amount**
	Reserve & Surplus:		
1	General Reserve	3,50,000	2,80,000
	Profit & Loss Balance	1,50,000	1,20,000

	Total	**5,00,000**	**4,00,000**
2	**Long Term Borrowing :** 10% Debenture	16,00,000	15,00,000
	Total	**16,00,000**	**15,00,000**
3	**Short Term Provisions:** Proposed Dividend Provision for Taxation	 30,000 20,000	 27,000 13,000
	Total	**50,000**	**40,000**
4	Tangible Asset :- Plant & Machinery	39,50,000	34,60,000
	Total		
5	**Intangible Assets :- Goodwill**	**50,000**	**40,000**
6	**Current Investments :** Marketable Securities	**10,000**	**30,000**

Additional Information:-

(1) The debenture were issued on 1.04.2017.
(2) Machinery costing Rs 70,000/- (accumulated depreciation thereon Rs 10,000) was sold for Rs 45,000.
(3) Machinery Costing Rs 8,00,000 was purchased during the year.
(4) Interim Dividend of Rs 11,000 was paid during the year.

Problem No. 5. From the following information, prepare Cash Flow Statement for Elegant Ltd.

Balance Sheet of Pioneer Ltd., as on March 31, 2018

	Particulars	*Note No.*	*31st March 2018*	*31st March 2017*
	I. Equity and Liabilities			
1	Shareholders' Funds			
	a) Share capital	1	7,00,000	5,00,000
	b) Reserve and surplus	2	3,50,000	2,00,000
2	Non-current Liabilities			
	Long-term borrowings: Bank Loan		50,000	1,00,000
3	Current Liabilities			
	a) Trade payables		45,000	50,000
	b) Other current liabilities: outstanding rent		7,000	5,000
	c) Short-term provisions	3	1,20,000	80,000
	Total		**12,72,000**	**9,35,000**
II. Assets				
1	Non-current assets			

	a) Fixed assets			
	(i) Tangible assets	4	5,00,000	5,00,000
	(ii) Intangible assets	5	95,000	1,00,000
	b) Non-current investments		1,00,000	-
2	Current assets			
	a) Inventories		1,30,000	50,000
	b) Trade receivables		1,20,000	80,000
	c) Cash and cash equivalents	6	3,27,000	2,05,000
	Total		**12,72,000**	**9,35,000**

	Particulars	***31st March 2018 (Rs)***	***31st March 2017 (Rs)***
	1 Equity Share Capital	**7,00,000**	**5,00,000**
	2 Reserve and Surplus		
	Surplus: i.e., Balance in Statement of Profit & Loss A/C	3,50,000	2,00,000
	3. Short-term Provision:		
	Proposed Dividend	70,000	50,000
	Provision for Taxation	50,000	30,000
		1,20,000	**80,000**
	Fixed Assets		
	Tangible		
	Equipment	2,30,000	2,00,000
	Furniture	2,70,000	3,00,000
		5,00,000	**5,00,000**
	Intangible Assets		
	Patents	**95,000**	**1,00,000**
	Cash and cash equivalents		
	(i) Cash	27,000	5,000
	ii) Bank balance	3,00,000	2,00,000
		3,27,000	**2,05,000**

Additional Information :

1) During the year, equipment costing Rs 80,000 was purchased.

2) Loss on Sale of equipment amounted to Rs 5,000.

3) Depreciation of Rs 15,000 and Rs 3,000 charged on equipment's and furniture.

Problem No. 6 From the following Balance Sheets of Rayan Ltd., prepare cash flow statement

	Particulars	***Note No.***	***31st March 2018***	***31st March 2017***
	I. Equity and Liabilities			
1	Shareholders' Funds			
	a) Share capital		15,00,000	10,00,000
	b) Reserve and surplus (Balance in Statement of Profit and Loss)		7,50,000	6,00,000
2	Non-current Liabilities			
	Long-term borrowings	1	1,00,000	2,00,000
3	Current Liabilities			
	a) Trade payables		1,00,000	1,10,000
	b) Short-term provisions		95,000	80,000
	(Provision for taxation)			
	Total		**25,45,000**	**19,90,000**
	II. Assets			
	Non-current assets			
1	a) Fixed assets			
	(i) Tangible assets	2	10,10,000	12,00,000
	(ii) Intangible assets (Goodwill)		1,80,000	2,00,000
	b) Non-current investment		6,00,000	-
	Current assets			
2	a) Inventories		1,80,000	1,00,000
	b) Trade Receivables		2,00,000	1,50,000
	c) Cash and cash equivalents	3	3,75,000	3,40,000
	Total		**25,45,000**	**19,90,000**

Notes to Accounts

	Particulars	***31st March 2018***	***31st March 2017***
1	Long-term Borrowings:		
	i) Debentures		2,00,000
	ii) Bank loan	1,00,000	
		1,00,000	**2,00,000**
2	Tangible Assets		

	i) Land and building	6,50,000	8,00,000
	ii) Plant and machinery	3,60,000	4,00,000
		10,10,000	**12,00,000**
3	Cash and cash equivalents		
	i) Cash in hand	70,000	50,000
	ii) Bank balance	3,05,000	2,90,000
		3,75,000	**3,40,000**

Additional information:

1. Dividend proposed and paid during the year Rs 1,50,000.
2. Income tax paid during the year includes Rs 15,000 on account of dividend tax.
3. Land and building book value Rs 1,50,000 was sold at a profit of 10%.
4. The rate of depreciation on plant and machinery is 10%.

Problem No. 7 From The Following Information Of Oswal Mills Ltd., Prepare Cash Flow Statement:

Balance Sheet of Oswal Mills as on 31st March, 2017 and 2018

	Particulars	***Note No.***	***31st March 2018 (Rs)***	***31st March 2017 (Rs)***
	I. Equity and Liabilities			
1	Shareholders' Funds			
	a) Share capital	1	1,300	1,400
	b) Reserve and surplus (Surplus)		4,700	4,000
2	Current Liabilities			
	a) Short-term loan		200	600
	b) Trade payables		500	400
	Total		**6,700**	**6,400**
	II. Assets			
1	Non-current assets			
	a) Fixed assets	2	2,400	2,400
	b) Non-current investments		300	200
2	Current assets			
	a) Inventories		1,200	1,300
	b) Trade receivables		800	900
	c) Cash and cash equivalents		1,200	800
	d) Short-term loans and advances		800	800
	Total		**6,700**	**6,400**

Notes to Accounts:

(Rs in Lakhs)

Particulars	***31st March 2017***	***31st March 2018***
1 Share capital		
Equity share capital	1,000	1,000
10% preference share capital	300	400
	1,300	**1,400**
2 Fixed assets		
Tangible assets	3,600	3,400
Less: Accumlated depreciation	-1,200	-1,000
	2,400	**2,400**

Statement of Profit and Loss for the year ended 31st March, 2018

Particulars	***Note No.***	***31st March 2018***	***31st March 2017***
I. Revenue from operation		2,800	-
II. Other income (dividend income)		1,000	-
III. Total Revenue		3,800	-
IV. Expenses			-
Cost of material consumed		400	-
Employees benefit expenses		200	-
Finance cost (interest paid)		200	-
Depreciation		200	-
Loss due to earthquake		1,100	-
		2,100	
V. Profit before tax		1,700	-
VI. Tax paid		1,000	-
Profit after tax		700	-

Additional information:

1. No dividend paid by the company during the current financial year.
2. Out of fixed assets, land worth Rs 1,000 Lakhs having no accumulated depreciation was sold at no profit or no loss

Problem No.8 From the following Balance Sheets of XYL Limited, Prepare Cash Flow Statement:

Particulars	Note No.	31.03.2018	31.03.2017
Equity and Liabilities :		Amount	Amount
a)Shareholder's Funds :	1		
a) Share Capital		2,50,000	2,25,000
b) Reserve & Surplus		2,60,000	1,15,000
(1) Current Liabilities			
a) Trade Payables		49,500	37,500
b) Short Term Provisions	2	50,000	40,000
Total		**6,09,500**	**4,17,500**
I. Assets :			
(1) Non-Current Assets :			
(a) Fixed Assets			
(i) Tangible Assets	3	2,80,000	2,40,000
(ii) Intangible Assets	4	20,000	36,000
(2) Current Assets :			
(a) Inventory		15,000	10,000
(b) Trade Receivables		2,84,500	1,19,000
(c) Cash & Cash Equivalents		10,000	12,500
Total		**6,09,500**	**4,17,500**

Particulars	**31.03.2018**	**31.03.2017**
	Amount	**Amount**
Share Capital		
Equity Share Capital	2,00,000	1,50,000
Preference Share Capital	50,000	75,000
	2,50,000	2,25,000
Reserve & Surplus:		
General Reserve	1,25,000	70,000
Profit & Loss Balance	1,35,000	45,000
Total	2,60,000	1,15,000
Short Term Provisions:		
Provision for Taxation	50,000	40,000
Total		

Tangible Assets :		
Land & Building	1,80,000	2,00,000
Plant	1,00,000	40,000
Total	2,80,000	2,40,000
Intangible Assets :		
Goodwill	20,000	36,000

Additional Information:-

a) Depreciation of Rs 10,000 & Rs. 60,000 has been charged on plant, land & Building respectively.
b) Income Tax of Rs 43,000 has been paid.

Problem No.9 From The Following Information Of Oswal Mills Ltd., Prepare Cash Flow Statement:

	Particular	Note No.	31.03.2018	31.03.2017
	I. Equity and Liabilities :		**Amount**	**Amount**
	(1) Shareholder's Funds :			
	(a) Share Capital		4,50,000	4,50,000
	(b) Reserve & Surplus	1	4,78,000	3,56,000
	(2) Non-Current Liabilities :			
	Long-term Borrowings	2	1,70,000	-
	(3) Current Liabilities :			
	(a) Trade Payables		1,09,000	2,03,000
	(b) Short Term Provision	3	35,000	40,000
	Total		**12,42,000**	**10,49,000**
	II. Assets :			
	(1) Non-Current Assets :			
	Fixed Assets			
	(i) Tangible Assets	4	32000	4,00,000
	(ii) Intangible Assets	5	60000	50,000
	(2) Current Assets :			
	(a) Current Investments		70000	78,000
	(b) Inventory		1,70,000	2,15,000
	(c) Trade Receivables		4,55,000	2,10,000
	(d) Cash & Bank		1,67,000	96,000
	TOTAL		**12,42,000**	**10,49,000**

Notes :

	(1) Reserve & Surplus :	**31.02.2018**	**31.03.2017**
	Retained Earnings	4,78,000	3,56,000
	(2) Long-term Borrowings :		
	Mortgage Loan	1,70,000	-
	(3) Short-term Provision **:**		
	Provision for Taxation	35,000	40,000
	(4) Tangible Assets :		
	Land	1,40,000	2,50,000
	Plant & Machinery	1,80,000	1,50,000
		3,20,000	**4,00,000**
	(5) Intangible Assets : Goodwill	60,000	50,000

Additional Information::

(i) Gain on sale of Land Rs.30,000

(ii) Depreciation on Plant & Machinery was provided at 10% on last year's balance

(iii) Interest paid on Mortgage Loan amounted To Rs. 24,300.

(iv) Provision for income tax made during the year 2017-18 was Rs. 32,000

Problem No.10 From the following Balance Sheets of M/s Cube Limited, Prepare Cash Flow Statement:

	Particulars	**Note No.**	**31.03.2018**	**31.03.2017**
	I. Equity and Liabilities :			
	(1) Shareholder's Funds :			
	a) Share Capital		2,00,000	2,00,000
	b) Reserve & Surplus		1,55,000	80,000
	(2) Current Liabilities			
	a) Trade Payables		1,28,000	1,45,000
	b) Short Term Provisions	1	45,000	35,000
	Total		5,28,000	4,60,000
	II. Assets :			
	(1) Non-Current Assets :			
	(a) Fixed Assets			
	(i) Tangible Assets	2	2,00,000	1,50,000
	(ii) Intangible Assets	3	33,000	40,000
	(2) Current Assets :			
	a) Current Investments	4	15,000	12,000
	b) Inventory		2,15,000	1,80,000
	c) Trade Receivables		50,000	60,000
	d) Cash & Bank		10,000	8,000
	e) Other Current Assets	5	5,000	10,000

	Total		5,28,000	4,60,000

Notes:

(1) Short-term Provision **:**	**31.03.2018**	**31.03.2017**
Provision for Taxation	45,000	35,000
(2) Tangible Assets :		
Machinery	2,00,000	1,50,000
(3) Intangible Assets :		
Goodwill	33,000	40,000
(4) Current Investment :		
Marketable Securities	15,000	12,000
(5) Other Current Assets :		
Prepaid Expenses	5,000	10,000

Additional Information::

(i) Machinery whose original cost was Rs. 50,000 was sold for Rs. 10,000 during the year. Accumulated Depreciation on this machinery was Rs 26,000

(ii) Depreciation on Machinery was provided Rs.20,000

(iii) Dividend Paid during the year @ 10% on equity share capital

***Problem No.*11** from the following balance sheet of M/s Clean & Clear Company Ltd. As at 31st March 2018 & 31st March 2017**.** Prepare Cash Flow Statement:

	Particulars	**Note No.**	**31.03.2018**	**31.03.2017**
	I. Equity and Liabilities :			
	(1Shareholder's Funds :			
	a) Share Capital		1,05,000	75,000
	b)Reserve & Surplus	1	85,000	50,000
	(2 Current Liabilities			
	a) Short Term Borrowings	2	25,000	15,000
	b)Trade Payables	3	22,000	17,400
	Total		**2,37,000**	**1,57,400**
	II. Assets :			
	(1) Non-Current Assets :			
	Fixed Tangible Assets		**1,66,000**	**93,400**
	(2 Current Assets :			

	a) Inventory		27,000	24,000
	b)Trade Receivable	4	39,000	36,000
	c) Cash & Cash Equivalents		5,000	4,000
	Total		**2,37,000**	**1,57,400**

(1) Reserve & Surplus :		
General Reserve	55,000	30,000
Balance of Statement of Profit & Loss	30,000	20,000
	85,000	50,000
(2) Short-term Borrowings :		
Bank Overdraft	25,000	15,000
(3) Trade Payables :		
Sundry Creditors	20,000	14,000
Bills Payables	2,000	3,400
(4) Trade Receivables :		
Sundry Debtors	36,000	36,000
Bills Receivables	3,000	0
	39,000	36,000

Additional Information::

(i) Depreciation charged on fixed tangible assets for the year 2017-18 was Rs. 20,000

(ii) Income tax of Rs. 5,000 Paid during the year.

***Problem No*.12** from the following balance sheet of M/s Super Fast Expres Ltd., s As at 31st March 2018 & 31st March 2017**.** Prepare Cash Flow Statement

	Particulars	Note No.	31.03.2018	31.03.2017
	I. Equity and Liabilities :			
	(1)Shareholder's Funds :			
	a) Share Capital		10,00,000	7,00,000
	b)Reserve & Surplus		2,50,000	1,50,000
	(2)Current Liabilities			
	a)Short Term Provisions	1	50,000	40,000
	Total		**13,00,000**	**8,90,000**
	II. Assets :			
	(1)Non-Current Assets :			
	Fixed Tangible Assets	2	8,00,000	5,00,000
	(2) Current Assets :			

	a) Current Investments (Short-term Investments)		60,000	45,000
	b) Inventory		1,00,000	75,000
	c) Cash & Cash Equivalents		3,40,000	2,70,000
	Total		**13,00,000**	**8,90,000**

Notes: (1) Short-term Provision **:**		
Proposed Dividend	50,000	40,000
(2) Fixed Tangible Assets :		
Plant & Machinery	8,00,000	5,00,000

Additional Information::

(i) Rs.50,000 depreciation has been charged to Plant & Machinery during the year 2017-18

(ii) A Piece of Machinery costing Rs. 21,000 (book value Rs.50,000) was sold at a profit at 60% profit book value.

Problem No.13 from the following Balance Sheet of M/s Fast & Forward Ltd., As at 31st March 2018 & 31st March 2017. *Prepare Cash Flow Statement*

	Particulars	**Note No**	**31.03.2012**	**31.03.2011**
	I. Equity and Liabilities :			
	(1) Shareholder's Funds :			
	a) Share Capital	1	8,50,000	4,60,000
	b) Reserve & Surplus	2	1,70,000	2,40,000
	(2) Non-Current Liabilities :			
	a) Long-term Borrowings	3	1,80,000	2,00,000
	Total		12,00,000	9,00,000
	II. Assets :			
	(1) Non-Current Assets :			
	a) Fixed Assets		7,00,000	5,00,000
	(2) Current Assets :			
	a) Inventory		2,50,000	2,10,000
	b) Trade Receivable		1,90,000	1,40,000
	c) Cash & Cash Equivalents		60,000	50,000
	Total		12,00,000	9,00,000

Notes : (1) Share Capital :	**31.03.2018**	**31.03.2017**
Equity Share Capital	7,50,000	4,00,000

8% Preference Share Capital	1,00,000	60,000
	8,50,000	**4,60,000**
(2) Reserve & Surplus :		
General Reserve	50,000	70,000
Profits & Loss Balance	1,20,000	1,70,000
	1,70,000	**2,40,000**
(3) Long-term Borrowings :		
10% Debentures	1,80,000	2,00,000

Additional Information:-

(i) During the year Machine costing Rs. 80,000 was sold for Rs. 50,000

(ii) Dividend Paid Rs. 80,000

Problem No.14 From the following Balance Sheets of M/s Weak Ltd., Limited, prepare Cash Flow Statement:

	Particulars	Note No	31.03.2018	31.03.2017
	I. Equity and Liabilities :		Amount	Amount
	(1) Shareholder's Funds :	1		
	a) Share Capital		1,05,000	75,000
	b)Reserve & Surplus		85,000	50,000
	(2)Current Liabilities			
	a)Trade Payables		22,000	17,400
	b)Short Term Borrowing	2	25,000	15,000
	Total		**2,37,000**	**1,57,400**
	II. Assets :			
	(1)Non-Current Assets :			
	(a)Fixed Assets			
	(i)Fixed Tangible Assets	3	1,66,000	93,400
	(ii) Intangible Assets	4	---	------
	(2) Current Assets :			
	(a) Inventory		27,000	24,000
	(b) Trade Receivables		39,000	36,000
	(c) Cash & Cash Equivalents		5,000	4,000
	Total		**2,37,000**	**1,57,400**

Note No.	Particulars	31.03.2018	31.03.2017

1	**Reserve & Surplus:**		
	General Reserve	55,000	30,000
	Profit & Loss Balance	30,000	20,000
		85,000	50,000
2	**Short term borrowing**		
	Bank overdraft	25,000	15,000
	Trade payables		
	Sundry creditors	20,000	14,000
	Bills payable	2,000	3,400
	Total	22,000	17,400
3	**Trade receivables**		
	Debtors	36,000	36,000
	Bill receivable	3,000	---
	Total	39,000	36,000

Problem No.15 From the following information of M/s New Light India Ltd., Prepare a cash flow statement:

	Particulars	*Note No.*	*31st March 2018 (Rs)*	*31st March 2017 (Rs)*
	I. Equity and Liabilities			
1	Shareholders' Funds			
	a) Share capital		1,500	1,250
	b) Reserve and surplus (surplus)		3,410	1,380
2	Non-current Liabilities			
	Long-term borrowings		1,110	1,040
	(Long-term loan)			
3	Current Liabilities			
	a) Trade payables		150	1,890
	b) Other current liabilities	1	630	1,100
	Total		**6,800**	**6,660**
	II. Assets			
1	Non-current assets			
	a) Fixed assets	2	730	850
	b) Non-current investments		2,500	2,500
2	Current assets			
	a) Current investments (Marketable)		670	135
	b) Inventories		900	1,950

	c) Trade Receivables		1,700	1,200
	d) Cash and cash equivalents		200	25
	e) Other Current Assets (Interest receivables)		100	
Total			**6,800**	**6,660**

Notes to Accounts:

	Particulars	***31st March 2018***	***31st March 2017)***
1	Other Current Liabilities		
	i) Interest payable	230	100
	ii) Income tax payable	400	1,000
		630	**1,100**
2	Fixed Assets:	2,180	1,910
	Tangible	-1,450	-1,060
	Less: Accumulated depreciation	**730**	**850**

Statement of Profit and Loss for the year ended 31st March, 2018

(Rupees in Lakhs)

	Particulars	Note No.	*31st March 2017 (Rs)*
I	Revenue from operation		30,650
II	Other income	1	640
III Total Revenue			31,290
IV.	Expenses		
	Cost of material consumed		
	Finance cost (interest expenses)		26,000
	Depreciation		400
	Other expenses		450
	Admn. and selling expenses		910
	Total expenses		**27,760**
	Profit before tax		3,530
	Less: Tax		-300
	Profit after tax		3,230

Notes to Accounts:

Particulars	
1. Other Income during the year 2017-18	300
i) Interest Income	200

ii) Dividend Income	140
iii) Insurance Proceeds from earthquake disaster Settlement	**640**

Additional Information: (Rs '000)

(i) An amount of Rs 250 was raised from the issue of share capital and a further Rs 250 was raised from long-term borrowings.

(ii) Interest expense was Rs 400 of which Rs 170 was paid during the period. Rs 100 relating to interest expense of the prior period was also paid during the period.

(iii) Dividends paid were Rs 1,200.

(iv) Tax deducted at source on dividends received (included in the tax expense of Rs 300 for the year) amounted to Rs 40.

Ratio Analysis

A relationship between various accounting figures, which are connected with each other, expressed in mathematical terms, is called accounting ratios.

According to **Kennedy and Macmillan**, "The relationship of one item to another expressed in simple mathematical form is known as ratio."

Robert Anthony defines a ratio as – "simply one number expressed in terms of another."

Accounting ratios are very useful as they briefly summarise the result of detailed and complicated computations. Absolute figures are useful but they do not convey much meaning. In terms of accounting ratios, comparison of these related figures makes them meaningful. For example, profit shown by two-business concern is Rs. 50,000 and Rs. 1, 00,000. It is difficult to say which business concern is more efficient unless figures of capital investment or sales are also available.

Analysis and interpretation of various accounting ratio gives a better understanding of the financial condition and performance of a business concern.

Ratio analysis is one of the techniques of financial analysis to evaluate the financial condition and performance of a business concern. Simply, ratio means the comparison of one figure to other relevant figure or figures.

According to **Myers**, "Ratio analysis of financial statements is a study of relationship among various financial factors in a business as disclosed by a single set of statements and a study of trend of these factors as shown in a series of statements."

Advantages and Uses of Ratio Analysis

There are various groups of people who are interested in analysis of financial position of a company. They use the ratio analysis to work out a particular financial characteristic of the company in which they are interested. Ratio analysis helps the various groups in the following manner:

1. **To work out the profitability:** Accounting ratio help to measure the profitability of the business by calculating the various profitability ratios. It helps the management to know about the earning capacity of the business concern. In this way profitability ratios show the actual performance of the business.
2. **To work out the solvency:** With the help of solvency ratios, solvency of the company can be measured. These ratios show the

relationship between the liabilities and assets. In case external liabilities are more than that of the assets of the company, it shows the unsound position of the business. In this case the business has to make it possible to repay its loans.

3. **Helpful in analysis of financial statement:** Ratio analysis help the outsiders just like creditors, shareholders, debenture-holders, bankers to know about the profitability and ability of the company to pay them interest and dividend etc.

4. **Helpful in comparative analysis of the performance:** With the help of ratio analysis a company may have comparative study of its performance to the previous years. In this way company comes to know about its weak point and be able to improve them.

5. **To simplify the accounting information:** Accounting ratios are very useful as they briefly summarise the result of detailed and complicated computations.

6. **To work out the operating efficiency:** Ratio analysis helps to work out the operating efficiency of the company with the help of various turnover ratios. All turnover ratios are worked out to evaluate the performance of the business in utilising the resources.

7. **To workout short-term financial position:** Ratio analysis helps to work out the short-term financial position of the company with the help of liquidity ratios. In case short-term financial position is not healthy efforts are made to improve it.

8. **Helpful for forecasting purposes:** Accounting ratios indicate the trend of the business. The trend is useful for estimating future. With the help of previous years' ratios, estimates for future can be made. In this way these ratios provide the basis for preparing budgets and also determine future line of action.

9. **Enables SWOT analysis:** Ratios help a great deal in explaining the changes occurring in the business. The information of change helps the management a great deal in understanding the current threats and opportunities and allows business to do its own SWOT (Strength-Weakness-Opportunity-Threat) analysis.

9) **Various comparisons:** Ratios help comparisons with certain bench marks to assess as to whether firm's performance is better or otherwise. For this purpose, the profitability, liquidity, solvency, etc. of a business, may be compared: (i) over a number of accounting periods with itself (Intra-firm Comparison/Time Series Analysis), with other business enterprises (Inter-firm Comparison/Cross-sectional Analysis) and with standards set for that firm/industry (comparison with standard (or industry expectations

Limitations of Ratio Analysis

In spite of many advantages, there are certain limitations of the ratio analysis techniques and they should be kept in mind while using them in interpreting financial statements. The following are the main limitations of accounting ratios:

1. **Limited Comparability:** Different firms apply different accounting policies. Therefore the ratio of one firm cannot always be compared with the ratio of other firm. Some firms may value the closing stock on LIFO basis while some other firms may value on FIFO basis. Similarly there may be difference in providing depreciation of fixed assets or certain of provision for doubtful debts etc.
2. **False Results:** Accounting ratios are based on data drawn from accounting records. In case that data is correct, then only the ratios will be correct. For example, valuation of stock is based on very high price, the profits of the concern will be inflated and it will indicate a wrong financial position. The data therefore must be absolutely correct.
3. **Effect of Price Level Changes:** Price level changes often make the comparison of figures difficult over a period of time. Changes in price affects the cost of production, sales and also the value of assets. Therefore, it is necessary to make proper adjustment for price-level changes before any comparison.
4. **Qualitative factors are ignored:** Ratio analysis is a technique of quantitative analysis and thus, ignores qualitative factors, which may be important in decision making. For example, average collection period may be equal to standard credit period, but some debtors may be in the list of doubtful debts, which is not disclosed by ratio analysis.
5. **Effect of window-dressing**: In order to cover up their bad financial position some companies resort to window dressing. They may record the accounting data according to the convenience to show the financial position of the company in a better way.
6. **Costly Technique**: Ratio analysis is a costly technique and can be used by big business houses. Small business units are not able to afford it.
7. **Misleading Results**: In the absence of absolute data, the result may be misleading. For example, the gross profit of two firms is 25%. Whereas the profit earned by one is just Rs. 5,000 and sales are Rs. 20,000 and profit earned by the other one is Rs. 10,00,000 and sales are Rs. 40,00,000. Even the profitability of the two firms is same but the magnitude of their business is quite different.
8. **Absence of standard university accepted terminology:** There are no standard ratios, which are universally accepted for comparison purposes. As such, the significance of ratio analysis technique is reduced.

Classification of Accounting Ratios

1. On the basis importance: a) Primary Ratio, b) Secondary Ratios, 1.b.i) Support ing Ratios, ii) General Explanatory Ratios, iii) Specific Explanatory Ratios.

2. On the basis of users: a) Ratios useful to Management, b) Ratios useful to Shareholders, c)Ratios useful to Creditors.

3. On the basis of Sources or financial statements: a) Balance Sheet Ratios, b) Revenue Statement or Profit & Loss Account Ratios, c) Mixed or Combined Ratios.

4. On the basis of functions or purposes: a) Profitability Ratio, b) Liquidity or Solvency Ratios, c) Financial Stability Ratios, d) Management Efficiency Ratios, e)Activity or General Efficiency Ratios, f) Capital Structure Ratios .4.b.i) Short-term Liquidity or Solvency Ratios ii) Long-term Solvency or Liquidity Ratios.

Accounting ratios can be classified from five viewpoints. Such classification of accounting ratios is discussed below:

I. Classification on the basis of importance: From the view point of importance, accounting ratios are two types. A. Primary Ratio and B. Secondary Ratios.

A. Primary Ratio: The ratio that explains the relation between the capital employed and operating profit of a firm is known as primary ratio. So, Primary Ratio = Operating Profit /Capital Employed

As this ratio is computed with the basic parameter of success or failure of the operating activities of a firm it is called primary ratio.859

B. Secondary Ratios: Barring primary ratio other ratios which are related to the measurement of success or failure of the operating activities (if a firm are known as secondary ratios. These ratios are computed with the help of secondary or supporting parameters and are used to confirm the trend indicated by the primary ratio. This is the reason for identifying these ratio as secondary ratios. Secondary ratios are again divided into the following three categories

(i) Supporting Ratios: Secondary ratios used to analyse the profitability position of a firm are known as supporting ratios. Such supporting ratios are computed as follows:

(a) Operating Profit / Total Sales

(b) Total Sales / Capital Employed

(ii) General Explanatory Ratios: Ratios which explain the relationship between any two general or common factors of success or failure f the operating activities of the firm are identified as general explanatory ratios. The following are the examples of general explanatory ratios:

(a) Various Costs / Net Sales

(b) Net Sales / Current Assets

(c) Net Sales / Fixed Assets

(iii)Specific Explanatory Ratios: Ratios which explain the relationship between any two special factors related to success or failure of operating performance of the firm are known as specific explanatory ratios. Some of the specific explanatory ratios are mentioned below:

(a) Various specific costs/ Net Sales

(b) Stock Turnover = Cost of Goods Sold /Average Stock

(c) Debtors Turnover = Credit Sales/ Average Debtors

(d) Creditors Turnover = Credit Purchase/ Average Creditors

II. Classification on the basis of users: From the viewpoint of users ratios may be divided into three categories. Such divisions are as follows:

A. Ratios useful to management: The tool of ratio analysis has the main aim of providing useful information to the management in a nut and shell form. Most of the ratios generally computed are useful to the management. Some important examples of ratios having practical use in managerial functions are as follows:

(i) Operating ratio, (ii) operating profit ratio, (iii) all ratios related to solvency and liquidity, (iv) all efficiency measuring ratios, (v) profitability ratios other than operating profit ratio, (vi) all ratios related to the capital structure analysis.

The above-mentioned ratios will be discussed in later stage of this chapter.

B. Ratios useful to shareholders: Being owners the shareholders of the company are often interested to know the financial stability and profit earning capacity of the firm. For getting such information they depend on the following ratios:

Ratio Analysis

(i) all profitability measuring ratios, (ii) all ratios related to the evaluation of financial strength or stability, (iii) rate of return per share, (iv) leverage ratios.

These ratios will also be discussed in the following part of this chapter.

C. Ratios useful to creditors: The creditors or suppliers of raw materials and other components get interested to know the safety of their investment and the scope of getting timely interest and repayment of the investment. For this purpose they take the help of the following ratios

(i) All ratios indicating short-term and long term solvency or debt repayment capacity.

(ii) All ratios related to financial stability, and

(iii) Capital structure ratios.

III. **Classification on the basis of sources or financial statements:** Classification of ratios on the basis of sources from where the components of ratios are taken i.e. the financial statements is probably the most important classification. From the viewpoint of sources i.e. the financial statements ratios are classified into three categories i.e. A. Balance Sheet Ratios, B. Profit and Loss Account or Revenue Statement Ratios and C. Mixed or Composite Ratios.

A. Balance Sheet Ratios: Ratios, both the components of which are taken from the information disclosed in the Balance Sheet, are identified as Balance Sheet Ratios. Such ratios are computed to analyse the relationship among the different numerical information expressed in a Balance Sheet. The following Balance Sheet Ratios are commonly used for financial statement analysis

(i) Current Ratio

(ii) Liquid or Quick or Acid Test Ratio

(iii) Absolute Liquid Ratio (also known as Cash Position Ratio)
(iv) Defensive Interval Ratio
(v) Proprietary or Net Worth Ratio
(vi) Assets—Proprietorship Ratio
(vii) Fixed Assets—Proprietorship Ratio
(viii) Net Assets—Proprietorship Ratio
(ix) Debt—Equity Ratio
(x) Net Worth to Debt Ratio
(xi) Capital Gearing Ratio
(xii) Fixed Assets to Current Assets Ratio
(xiii) Debt Ratio
(xiv) Equity Capital Ratio
(xv) Preference Capital Ratio
(xvi) Debenture Capital Ratio.

B. Profit and Loss Account or Revenue Statement Ratios: If both the components of a particular ratio are taken from the information disclosed in the Profit and Loss Account or the revenue statement the same is called Profit and Loss Account or Revenue Statement Ratio. The relationship that exists within the revenue and cost related items shown in the Profit and Loss Account is explained through Revenue Statement Ratios. The important Profit and Loss Account or Revenue Statement Ratios are stated below:
(i) Gross Profit or Gross Margin Ratio
(ii) Net Profit or Net Margin Ratio
(iii) Operating Ratio
(iv) Expense Ratio or Specific Expense Ratio
(v) Materials Consumed Ratio
(vi) Manufacturing Expense Ratio or Conversion Cost Ratio
(vii) Operating Profit Ratio -
(viii)Interest Coverage Ratio
(ix) Debt Service Ratio:
(x) Tax Provision Ratio
(xi) Preference Dividend Coverage Ratio
(xii) Equity Dividend Coverage Ratio
(xiii) Dividend Payout Ratio
(xiv) Financial Leverage Ratio
(xv) Operating Leverage Ratio

***C.* Mixed or Composite Ratios:** If in computation of any ratio one of the variables is taken from the information disclosed in the Profit and Loss Account and the other variable from the Balance Sheet, the said ratio is identified as Mixed or Composite Ratio. Mixed or Composite ratios consist of components taken by mixing up both the important financial statements. The cause and effect relationship that exists among the items shown in the Profit and Loss Account and in the Balance Sheet can be explained through such mixed or combined ratios. The commonly used Mixed or Composite Ratios are stated below:

Ratio Analysis

(i) Return on Capital Employed
(ii) Return on Proprietors' Fund or Equity
(iii) Return on Equity Shareholders' Fund
(iv) Return on Total Assets
(v) Return on Investment (ROI) -
(vi) Stock Turnover
(vii) Debtors or Receivables Turnover
(viii)Creditors or Payables Turnover
(ix) Fixed Assets Turnover
(x) Current Assets Turnover
(xi) Working Capital Turnover
(xii) Capital Turnover
(xiii) Proprietors' Fund Turnover
(xiv) Dividend Yield Ratio
(xv) Price Earning Ratio
(xvi) Earning per Share
(xvii) Earning Yield Ratio

IV. Classification on the basis of function or purpose: The technique of analysis through accounting ratios may be used by the financial analyst for variety of purposes. From the viewpoint of purposes of goals served ratios are divided into six categories. Along with classification of ratios on the basis of sources such purpose-wise classifications of ratios have also gained good importance in the present accounting and management world. Use or purpose based classifications of ratios are discussed in the following lines:

A. Profitability Ratios: Almost all the parties related to a firm like shareholders or owners, management. Creditors, employees, government and others are interested to know its profit earning capacity Decisions taken by the users and their future relationship with the firm are often guided by this information. For this purpose a financial analyst tries to measure the profitability position of the firm by selecting a few ratios. Ratios computed for the purpose of assessing the profitability position of a firm are as follows -

(a) Gross Profit or Gross Margin Ratio
(b) Operating Ratio
(c) Operating Profit Ratio
(d) Net Profit or Net Margin Ratio
(e) Return on Capital Employed
(f) Return on Proprietors' Fund or Net Worth
(g) Return on Total Assets
(h) Capital Turnover
(i) Earnings per Share

(j) Price Earnings Ratio.

B. Liquidity or Solvency Ratios: Creditors, probable investors. Debenture holders and other outside parties get interested to know the fate of their investments in the firm. For this purpose the try to assess the loan repayment capacity of the firm with the help of ratio analysis. For effecting efficient debt management financial managers may also be interested to assess the loan repayment capacity of the firm through ratio analysis. So ratios may be used for measuring the debt payment capacity of firm. Liquidity or solvency position of a firm may be analysed on the basis of time frame i.e. short-term liquidity or solvency and long-term liquidity or solvency.

(i) Short-term Liquidity or Solvency Ratios: These ratios are used to judge the capacity of the firm of repaying the debt of short-term creditors and trade payables. Short-term solvency ratios are often identified by the term 'liquidity ratios'. The following ratios are usually computed to measure the short-term solvency or liquidity position of a firm:

(a) Current Ratio
(b) Liquid or Quick or Acid Test Ratio
(c) Absolute Liquid Ratio
(d) Debtors' Turnover or Velocity
(e) Creditors' Turnover or Velocity
(f) Stock or Inventory Turnover or Velocity.

(ii) Long-term Liquidity or Solvency Ratios: These ratios are computed to assess the capacity of the firm to pay off the claims of debenture holders, preference shareholders and other long term creditors. The following ratios are generally used for this purpose:

(a) Debt Equity Ratio
(b) Debt to Total Capital Ratio
(c) Proprietary Ratio
(d) Current Assets—Proprietorship Ratio
(e) Interest Coverage Ratio

C. Financial Stability Ratios: The shareholders and management of the concern may often feel interested to know whether the financial position of the firm is stable enough or not. A firm with financial stability has all the potentials of future growth. In this context financial stability means the strength to absorb all sorts of financial shocks. Usually short-term and long-term solvency ratios along with some other ratios are used for measuring the financial stability of a firm. The important ratios used for this purpose are:

(i) Debt Equity Ratio
(ii) Proprietary Ratio
(iii) Current Ratio
(iv) Liquid or Quick or Acid Test Ratio
(v) Capital Gearing Ratio
(v) Fixed Assets Proprietorship Ratio

(vi) Net Worth to Net Sales Ratio.

D. Managerial Efficiency Ratios: Ratios are also used to measure managerial efficiency. The management is willing to make a self-appraisal of past performance. The owners or shareholders may also want to assess the efficiency of the agency on which they have entrusted the responsibility of running the concern. As managers are directly related to all activities of a firm many parameters must be tested for measuring its efficiency. Ratios which are computed for measuring managerial efficiency are stated below:

(i) Short-term Solvency Ratios: (a) Current Ratio, (b) Liquid or Quick or Acid Test Ratio.

(ii) Long term Solvency Ratios: (a) Debt-Equity Ratio. (b) Proprietary Ratio.

(iii) All Activity or Efficiency Ratios: as discussed in sub-paragraph E below:

(iv) Profitability Ratios: (a) Gross Profit Ratio, (b) Net Profit Ratio, (c) Operating Ratio. (d) Operating Profit Ratio. (e) Return on Capital Employed.

E. Activity or General Efficiency Ratios: Another purpose of ratio analysis technique is to measure the activity or general efficiency of the firm. Here not only managerial efficiency is measured, rather an effort is made to highlight the general efficiency of overall business activities. Such analysis is made by computing the turnover or velocity of the items directly related to operating activities in relation to the sales achieved by the firm. For this reason the ratios used for measuring activity or general efficiency are also called turnover ratios. Usually the following ratios are used for this purpose:

(i) Inventory Turnover or- Velocity
(ii) Fixed Assets Turnover
(iii) Total Assets Turnover
(iv) Debtors Turnover or Velocity
(v) Creditors Turnover or Velocity
(vi) Working Capital Turnover
(vii) Capital Employed Turnover

F. Capital Structure Ratios: The technique of ratio analysis may also be used to analyse the relationship between the financial stability of the firm and the composition of its capital structure. These ratios are known as capital structure ratios and they are also useful to measure the financial risk and operating risk involved in the activities of the firm. Capital structure ratios are of two types—(i) Leverage Ratios and (ii) Other Ratios.

(i) Leverage Ratios: (a) Financial Leverage Ratio, (b) Operating Leverage Ratio

(ii) Other Ratios: (a) Capital Gearing Ratio, (b) Debt Equity Ratio, (c) Fixed Assets to Net Worth Ratio, (d) Long-term Capital Employed to Long-term Liabilities Ratio, (e) Current Assets Proprietors Fund Ratio.

Numerical on Ratio Analysis

Problem No.1 From the following statement of Profit and loss of M/s Fast-Track company Ltd., Calculate Inventory Turnover Ratio. Operating Ratio

Statement of Profit And Loss

for the year ended 31st March, 2018

	Particulars	*Note No.*	*Rs.*
I.	Revenue from Operations		8,00,000
II.	Other Income		25,000
III.	Total Revenue (I + II)		**8,25,000**
IV.	Expenses :		
	Purchase of stock in trade		5,40,000
	Change in inventories of stock in trade	1	20,000
	Employee Benefit Expenses		90,000
	Depreciation and Amortization Exp.		15,000
	Other Exp.		10,000
	Total Expenses		**6,75,000**
V.	Profit before Tax (III - IV)		1,50,000
	Less: Tax		30,000
VI.	Profit after Tax		1,20,000

Notes to Account :

Change in Inventories of Stock in Trade :

Opening Inventory	80,000
Less : Closing Inventory	60,000
	20,000

Problem No. 2 From the following statement of Profit and loss of M/s Fireproof Company Ltd.,

Statement of Profit And Loss

For the year ended 31st March, 2018

	Particulars	*Note No.*	*Rs*
I.	Revenue from Operations		**5,00,000**
II.	Expenses		

	(a) Purchase of Stock in Trade		2,50,000
	(b) Change in Inventories of Stock in Trade	1	-8,000
	C) Employee Benefit Exp.	2	90,000
	(d) Other Expenses	3	48,000
	Total Expenses		**3,80,000**
	Profit Before Tax (I - II)		1,20,000

Notes to Accounts :

Change in Inventories of Stock in Trade	
Opening Inventory	60,000
Less : Closing Inventory	68,000
	(8000)
Employee Benefit Expenses	
Wages	58,000
Salaries	32,000
	90,000
Other Expenses :	
Carriage Inwards	20,000
Carriage Outwards	15,000
Miscellaneous Expenses	13,000
	48,000

Calculate Inventory Turnover Ratio; Average age of inventory & Operating Ratio

Problem No. 3 From the following statement of Profit and loss of M/s Sandalwood Company Ltd.,

	Particulars		*Rs*
I.	Revenue from Operations		4,40,000
	Less : Purchase	2,50,000	
II.	Changes in Inventories		
	(Opening Inventory - Closing Inventory)		
	(40,000 - 20,000)	20,000	
III.	Direct Expenses	30,000	3,00,000
	Gross Profit		1,40,000

Balance Sheet As At 31st March, 2018

Particulars	*Note No.*	*Rs.*
Equity And Liabilities :		
Shareholder's Fund :		
(a) Share Capital		3,00,000
(b) Reserve and Surplus	1	1,00,000
Current Liabilities :		
(a) Trade Payables		1,50,000
(b) Other Current Liabilities	2	50,000
TOTAL		**6,00,000**
Assets :		
Non-Current Assets		4,00,000
Current Assets :		
(a) Inventory		20,000
(b) Trade Receivables		1,00,000
© Cash & Cash Equivalents		80,000
TOTAL		**6,00,000**

Notes :

(1) Reserve & Surplus : Profit & Loss Balance 1,00,000

(2) Other Current Liabilities : Outstanding Salary 50,000

On the basis of the information given above, calculate any two of the following ratios **:** (i) Current Ratio, (ii) Inventory Turnover Ratio, (iii) Proprietary Ratio

Problem No.4 From the following Balance Sheet of M/s Mahavir Sport Equipment Company Ltd.,

Balance Sheet As At 31st March, 2018

Particulars	*Note No.*	*Rs*
Equity And Liabilities :		
Shareholder's Funds :		
(a) Share Capital		2,00,000
(b) Reserves and Surplus		1,80,000
Non-Current Liabilities :		
Long term Borrowings		2,40,000

Current Liabilities :		
Trade Payables		1,00,000
Total		**7,20,000**
ASSETS :		
Non-Current Assets		3,60,000
Current Assets :		
(a) Inventory		80,000
(b) Trade receivables		1,80,000
© Cash & Cash Equivalents		1,00,000
Total		**7,20,000**

Notes :

(1) Reserve & Surplus :	
General Reserve	80,000
Profit & Loss	1,00,000
	1,80,000
(2) Long Term Borrowings: Loan @ 15%	2,40,000

a) Revenue from Operations during the year amounted to Rs. 3,80,000
b) Revenue from Operations returns during the year amounted to Rs. 20,000

Calculate: (i) Working Capital Turnover Ratio, (ii) Debt Equity Ratio, (iii) Trade Receivables Turnover Ratio

Problem No. 5 From the following statement of Profit and loss of Worldone company Ltd., Calculate: (i) Operating Ratio, (ii) Operating Expenses Ratio,

Statement of Profit And Loss

for the year ended 31st March, 2018

	Particulars	*Note No.*	*Rs.*
I	Revenue from Operations		16,00,000
II	Add: Other Incomes		40,000
III	Total Revenue I + II		**16,40,000**
IV	*Less:* Expenses		
	Purchase of Stock-in-Trade		9,60,000
	Changes in Inventories of Stock in Trade		-25,000
	Employees Benefits Expenses		1,80,000

	Finance Costs		46,000
	Depreciation and Amortization Expenses		40,000
	Other Expenses	1	1,15,000
	Total Expenses		**13,16,000**
V	Profit before Tax (III - IV)		**3,24,000**

Notes to Accounts:

Particulars	*Rs.*
Other Expenses :	
Administrative Expenses	70,000
Selling Expenses	31,000
Loss on Sale of Machinery	14,000
	1,15,000

Problem No.6 From the following information find out COGS, GP, NP, CA, Capital & liability prepare Trading and P&L A/c

Gross profit Ratio	25%
Net profit Ratio	20%
Stock Turn over Ratio	10 times
Net Profit/Capital	1/5
Capital/Total liability	½
Fixed Assets/Capital	5/4
Fixed assets/Current Assets	5/7
Fixed Assets	10,00,000
Closing Stock	1,00,000
Sales	8,00,000

Problem No.7 From the given information prepare a statement of Shareholder fund

Stock Turnover Ratio	6 times
Debtors Velocity	2 months
Capital Turnover	2 times
Creditors velocity	73 days
Fixed assets turnover	4 times
Gross profit Ratio	20%
Reserve & Surplus	Rs. 20,000
Gross profit	Rs. 60,000

Problem No. 8 Prepare a statement of shareholders fund :- Annual sales Rs. 2,00,000; Sales/Net worth = 2.5 times; Current debt/Net worth = 25%; Total debts/Net worth 60%; Current ratio 3.6; Sales/Inventory 4 times; Average collection period 36 days (360 days); Fixed Assets/Net worth 70%.

Problem No. 9 Prepare Balance Sheet from the given information:-

Sales to Net worth	5 times
Current liabilities/Net worth	50%
Total debts/Net worth	60%
Fixed assets/Net worth	60%
Current Ratio	2 : 1
Sales/Stock	10 times
Debtors Velocity	90 days
Annual Sales	15,00,000

60% of the total sales were made on cash.

Problem No. 10 Current Ratio 2.5:1; liquid Ratio1.5:1; Proprietary ratio (F.A./P.F.) 0.75; working Capital Rs.60,000; Reserves & surplus Rs.40,000; Bank overdraft Rs.10,000. There is no long term loan & fictitious assets or intangible assets

Problem No. 11 Prepare trading; Profit & Loss A/c & Balance Sheer from the following data:-

Current Ratio	1.8 : 1
Working Capital	**Rs.40,000**
Liquid ratio (calculated with CL)	1.5 : 1
Fixed Assets/Shareholder Capital	90%
Gross profit Ratio	25%
Rate of Net profit/Share Capital	10%
Share Capital	Rs.4,00,000
Stock turnover Ratio	10 times
Average rate of o/s debtor	54 days

Current assets includes stock, debtors & bank Balance liability includes share capital & current liability. Assets include fixed assets, current assets & development expenses.

Problem No. 11 Assume that a firm has owner's equity of Rs. 1,00,000. The ratio's for the firm are (a) current debts to total debts 0.40 (b) Total debts to owners Equity 0.60 (c) Fixed assets to owners equity 0.60 (d) Total assets turnover ratio 2 times (e) Inventory turnover ratio 8 times.

Fill up the following proforma of balance sheet, given the information above.

Liabilities	**Amount**	**Assets**	**Amount**
Current debts		Cash	
Long term debts		Inventory	
Total debts		**Total Current Assets**	
(+) Owners equity		(+) Fixed Assets	
Total Capital		**Total Assets**	

Problem No. 12 The following ratios and other data relate to the financial statements of Jay Co. Ltd. for the year ending 31st Dec 1999

Working Capital (Current Ratio)	1.75 : 1
Acid test ratio	1.27 : 1
Working Capital	Rs. 33,000
Fixed assets to shareholders equity	0.625 : 1
Inventory Turnover (Based on closing stock)	4 times
Gross profit ratio	40%
Earning per share	Re. 0.50
Debtors collection period	73 days
No. of Shares issued	20,000
Earning for the year on share Capital	25%

The company had no prepaid expenses, differed charges intangible assets or long term liabilities you are required to drafter company balance sheet and profit & loss A/c with as much details as possible.

Unit IV: Budgeting and Budgetary Control:

Meaning and Definition:

Budget:

According to CIMA (Chartered Institute of Management Accountants) UK, a budget is "A plan quantified in monetary terms prepared and approved prior to a defined period of time, usually showing planned income to be generated and, expenditure to be incurred during the period and the capital to be employed to attain a given objective."

In a view of Keller &Ferrara , "a budget is a plan of action to achieve stated objectives based on predetermined series of related assumptions."

G. A. Welsh states, "a budget is a written plan covering projected activities of a firm for a definite time period."

One can elicit the explicit characteristics of budget after observing the above definitions. They are…

- It is mainly a forecasting and controlling device.
- It is prepared in advance before the actual operation of the company or project.
- It is in connection with a definite future period.
- Before implementation, it is to be approved by the management.
- It also shows capital to be employed during the period.

Budgetary Control:

Budgetary Control is a method of managing costs through preparation of budgets. Budgeting is thus only a part of the budgetary control. According to CIMA, "Budgetary control is the establishment of budgets relating to the responsibilities of executives of a policy and the continuous comparison of the actual with the budgeted results, either to secure by individual action, the objective of the policy or to provide a basis for its revision."

The main features of budgetary control are:

- ❖ Establishment of budgets for each purpose of the business.
- ❖ Revision of budget in view of changes in conditions.
- ❖ Comparison of actual performances with the budget on a continuous basis.
- ❖ Taking suitable remedial action, wherever necessary.
- ❖ Analysis of variations of actual performance from that of the budgeted performance to know the reasons thereof.

Objectives of Budgetary Control:

Budgeting is a forward planning. It serves basically as a tool for management control; it is rather a pivot of any effective scheme of control.

G. A. Welsch in his book, 'Budgeting - Profit Planning and Control' has rightly pointed out that 'Budgeting is the principal tool of planning and control offered to management by accounting function.' The objectives of budgeting may be summarized as follows:

1) **Planning:** Planning has been defined as the design of a desired future position for an entity and it rests on the belief that the future position

can be attained by uninterrupted management action. Detailed plans relating to production, sales, raw-material requirements, labour needs, capital additions, etc. are drawn out. By planning many problems estimated long before they arise and solution can be thought of through careful study. In short, budgeting forces the management to think ahead, to foresee and prepare for the anticipated conditions. Planning is a constant process since it requires constant revision with changing conditions.

2) **Co-ordination:** Budgeting plays a significant role in establishing and maintaining coordination. Budgeting assists managers in coordinating their efforts so that problems of the business are solved in harmony with the objectives of its divisions. Efficient planning and business contribute a lot in achieving the targets. Lack of co-ordination in an organization is observed when a department head is permitted to enlarge the department on the specific needs of that department only, although such development may negatively affect other departments and alter their performances. Thus, co-ordination is required at all vertical as well as horizontal levels.
3) **Measurement of Success:** Budgets present a useful means of informing managers how well they are performing in meeting targets they have previously helped to set. In many companies, there is a practice of rewarding employees on the basis of their accomplished low budget targets or promotion of a manager is linked to his budget success record. Success is determined by comparing the past performance with a previous period's performance.
4) **Motivation:** Budget is always considered a useful tool for encouraging managers to complete things in line with the business objectives. If individuals have intensely participated in the preparation of budgets, it acts as a strong motivating force to achieve the goals.
5) **Communication:** A budget serves as a means of communicating information within a firm. The standard budget copies are distributed to all management people that provides not only sufficient understanding and knowledge of the programmes and guidelines to be followed but also gives knowledge about the restrictions to be adhered to.
6) **Control:** Control is essential to make sure that plans and objectives laid down in the budget are being achieved. Control, when applied to budgeting, as systematized effort is to keep the management informed of whether planned performance is being achieved or not.

Advantages of Budgetary control:

In the light of above discussion one can see that, coordination and control help the planning. These are the advantages of budgetary control. But this tool offer many other advantages as follows:

his system provides basic policies for initiatives.

a. It enables the management to perform business in the most professional manner because budgets are prepared to get the optimum use of resources and the objectives framed.

b. It ensures team work and thus encourages the spirit of support and mutual understanding among the staff.

c. It increases production efficiency, eliminates waste and controls the costs.

d. It shows to the management where action is needed to remedy a position.

e. Budgeting also aids in obtaining bank credit.

f. It reviews the present situation and pinpoints the changes which are necessary.

g. With its help, tasks such as like planning, coordination and control happen effectively and efficiently.

h. It involves an advance planning which is looked upon with support by many credit agencies as a marker of sound management.

Limitations of Budgetary control:

1. It tends to bring about rigidity in operation, which is harmful. As budget estimates are quantitative expression of all relevant data, there is a tendency to attach some sort of rigidity or finality to them.

2. It being expensive is beyond the capacity of small undertakings. The mechanism of budgeting system is a detailed process involving too much time and costs.

3. Budgeting cannot take the position of management but it is only an instrument of management. 'The budget should be considered not as a master, but as a servant.' It is totally misconception to think that the introduction of budgeting alone is enough to ensure success and to security of future profits.

4. It sometimes leads to produce conflicts among the managers as each of them tries to take credit to achieve the budget targets.
5. Simple preparation of budget will not ensure its proper implementation. If it is not implemented properly, it may lower morale.
6. The installation and function of a budgetary control system is a costly affair as it requires employing the specialized staff and involves other expenditure which small companies may find difficult to incur.

Essentials of Effective Budgeting:

1) Support of top management: If the budget structure is to be made successful, the consideration by every member of the management not only is fully supported but also the impulsion and direction should also come from the top management. No control system can be effective unless the organization is convinced that the management considers the system to be important.

2) Team Work: This is an essential requirement, if the budgets are ready from "the bottom up" in a grass root manner. The top management must understand and give enthusiastic support to the system. In fact, it requires education and participation at all levels. The benefits of budgeting need to be sold to all.

3) **Realistic Objectives:** The budget figures should be realistic and represent logically attainable goals. The responsible executives should agree that the budget goals are reasonable and attainable.
4) **Excellent Reporting System:** Reports comparing budget and actual results should be promptly prepared and special attention focused on significant exceptions i.e. figures that are significantly different from expected. An effective budgeting system also requires the presence of a proper feed-back system.
5) **Structure of Budget team:** This team receives the forecasts and targets of each department as well as periodic reports and confirms the final acceptable targets in form of Master Budget. The team also approves the departmental budgets.
6) **Well defined Business Policies:** All budgets reveal that the business policies formulated by the higher level management. In other words, budgets should always be after taking into account the policies set for particular department or function. But for this purpose, policies should be precise and clearly defined as well as free from any ambiguity.
7) **Integration with Standard Costing System:** Where standard costing system is also used, it should be completely integrated with the budget programme, in respect of both budget preparation and variance analysis.
8) **Inspirational Approach:** All the employees or staff other than executives should be strongly and properly inspired towards budgeting system. Human beings by nature do not like any pressure and they dislike or even rebel against anything forced upon them.

Classification of Budget:

The extent of budgeting activity varies from firm to firm. In a smaller firm there may be a sales forecast, a production budget, or a cash budget. Larger firms generally prepare a master budget. Budgets can be classified into different ways from different points of view. The following are the important basis for classification:

Classification of Budget

Function
- Labour Budget
- *Sales Budget*
- Production Budget
- Raw Materials Budget
- Purchase Budget
- Production Overhead Budget
- Selling & Distribution Budget
- Administration Cost Budget
- Capital Expenditure Budget
- Cash Budget

Flexibility
- Fixed Budget
- Flexible Budget

Time
- Long-Term Budget
- Short-Term Budget
- Current Budget
- Rolling Budget

Function

SALES BUDGET:

The sales budget is an estimate of total sales which may be articulated in financial or quantitative terms. It is normally forms the fundamental basis on which all other budgets are constructed. In practice, quantitative budget is prepared first then it is translated into economic terms. While preparing the Sales Budget, the Quantitative Budget is generally the starting point in the operation of budgetary control because sales become, more often than not, the principal budget factor. The factor to be consider in forecasting sales are as follows:

- Study of past sales to determine trends in the market.
- Estimates made by salesman various markets of company products.
- Changes of business policy and method.
- Government policy, controls, rules and Guidelines etc.
- Potential market and availability of material and supply.

PRODUCTION BUDGET:

The production budget is prepared on the basis of estimated production for budget period. Usually, the production budget is based on the sales budget. At the time of preparing the budget, the production manager will consider the physical facilities like plant, power, factory space, materials and labour, available for the period. Production budget envisages the production program for achieving the sales target. The budget may be expressed in terms of quantities or money or both. Production may be computed as follows: Units to be produced = Desired closing stock of finished goods + Budgeted sales – Beginning stock of finished goods.

PRODUCTION COST BUDGET:

This budget shows the estimated cost of production. The production budget demonstrates the capacity of production. These capacities of production are expressed in terms of cost in production cost budget. The cost of production is shown in detail in respect of material cost, labour cost and factory overhead. Thus production cost budget is based upon Production Budget, Material Cost Budget, Labour Cost Budget and Factory overhead.

RAW-MATERIAL BUDGET:

Direct Materials budget is prepared with an intention to determine standard material cost per unit and consequently it involves quantities to be used and the rate per unit. This budget shows the estimated quantity of all the raw materials and components needed for production demanded by the production budget. Raw material serves the following purposes:

- It supports the purchasing department in scheduling the purchases.
- Requirement of raw-materials is decided on the basis of production budget.

- It provides data for raw material control.
- Helps in deciding terms and conditions of purchase like credit purchase, cash purchase, payment period etc.
- It should be noted that raw material budget generally deals with only the direct materials whereas indirect materials and supplies are included in the overhead cost budget.

PURCHASE BUDGET:

Strategic planning of purchases offers one of the most important areas of reduction cost in many concerns. This will consist of direct and indirect material and services. The purchasing budget may be expressed in terms of quantity or money. The main purposes of this budget are:

- It designates cash requirement in respect of purchase to be made during budget period; and
- It is facilitates the purchasing department to plan its operations in time in respect of purchases so that long term forward contract may be organized.

LABOUR BUDGET:

Human resources are highly expensive item in the operation of an enterprise. Hence, like other factors of production, the management should find out in advance personnel requirements for various jobs in the enterprise. This budget may be classified into labour requirement budget and labour recruitment budget. The labour necessities in the various job categories such as unskilled, semi-skilled and supervisory are determined with the help of all the head of the departments. The labour employment is made keeping in view the requirement of the job and its qualifications, the degree of skill and experience required and the rate of pay.

PRODUCTION OVERHEAD BUDGET:

The manufacturing overhead budget includes direct material, direct labour and indirect expenses. The production overhead budget represents the estimate of all the production overhead i.e. fixed, variable, semi-variable to be incurred during the budget period. The reality that overheads include many different types of expenses creates considerable problems in:

1) Fixed overheads i.e., that which is to remain stable irrespective of vary in the volume of output,
2) Apportion of manufacturing overheads to products manufactured, semi variable cost i.e., those which are partly variable and partly fixed.
3) Control of production overheads.
4) Variable overheads i.e., that which is likely to vary with the output.

The production overhead budget engages the preparation of overheads budget for each division of the factory as it is desirable to have estimates of manufacturing overheads prepared by those overheads to have the responsibility for incurring them. Service departments cost are projected and allocated to the production departments in the proportion of the services received by each department.

SELLING AND DISTRIBUTION COST BUDGET:

The Selling and Distribution Cost budget is estimating of the cost of selling, advertising, delivery of goods to customers etc. throughout the budget period. This budget is closely associated to sales budget in the logic that sales forecasts significantly influence the forecasts of these expenses. Nevertheless, all other linked information should also be taken into consideration in the preparation of selling and distribution budget. The sales manager is responsible for selling and distribution cost budget. Naturally, he prepares this budget with the help of managers of sub-divisions of the sales department. The preparation of this budget would be based on the analysis of the market condition by the management, advertising policies, research programs and many other factors. Some companies prepare a separate advertising budget, particularly when spending on advertisements are quite high.

ADMINISTRATION COST BUDGET:

This budget includes the administrative costs for non-manufacturing business activities like directors fees, managing directors' salaries, office lightings, heating and air condition etc. Most of these expenses are fixed so they should not be too difficult to forecast. There are semi-variable expenses which get affected by the expected rise or fall in cost which should be taken into account. Generally, this budget is prepared in the form of fixed budget.

CAPITAL- EXPENDITURE BUDGET:

This budget stands for the expenditure on all fixed assets for the duration of the budget period. This budget is normally prepared for a longer period than the other functional budgets. It includes such items as new buildings, land, machinery and intangible items like patents, etc. This budget is designed under the observation of the accountant which is supported by the plant engineer and other functional managers. At the time of preparation of the budget some important information should be observed:

- Overfilling on the production facilities of certain departments as revealed by the plant utilization budget.
    - Long-term business policy with regard to technical developments.
    - Potential demand for certain products.

CASH BUDGET:

The cash budget is a sketch of the business estimated cash inflows and outflows over a specific period of time. Cash budget is one of the most important and one of the last to be prepared. It is a detailed projection of cash receipts from all sources and cash payments for all purposes and the resultants cash balance during the budget. It is a mechanism for controlling and coordinating the fiscal side of business to ensure solvency and provides the basis for forecasting and financing required to cover up any deficiency in cash. Cash budget thus plays a vital role in the financing management of a business undertaken.

Cash budget assists the management in determining the future liquidity requirements of the firm, forecasting for business of those needs, exercising control over cash. So, cash budget thus plays a vital role in the financial management of a business enterprise.

Function of Cash Budget:

- It makes sure that enough cash is available when it is required.
- It designates cash excesses and shortages so that steps may be taken in time to invest any excess cash or to borrow funds to meet any shortages.
- It shows whether capital expenditure could be financed internally.
- It provides funds for standard growth.
- It provides a sound basis to manage cash position.

Advantages of Cash Budget:

1. **Usage of Cash:** Management can plan out the use of cash in accord with the changes of receipt and payment. Payments can be planned when sufficient cash is available and continue the business activity with the minimum amount of working capital.
2. **Allocation for Capital Investment:** It is dual benefits such as capital expenditure projects can be financed internally and can get an idea for cash availability of capital investment.
3. **Provision of Excess Funds:** It reveals the availability of excess cash. In this regard management can decide to invest excess funds for short term or long term according to the requirements in the business.
4. **Pay-out Policy:** This budgetary system may help the management for future pay-out policy in the form of dividend. In case the cash budget liquid position is not favourable, the management may reduce the rate of dividend or maintain dividend amount or skip dividend for the year.
5. **Provision for acquiring Funds:** It gives the top level management ideas for acquiring funds for a particular time duration and sources to be explored.
6. **Profitable Use of Cash: Business** person can take decision for the best use of liquidity to make more profitable transaction. It can be used at the time of bulk purchase payments and one get the benefit of discount.

Limitation of Cash Budget:

1. **Complex Assumption:** Business is full of uncertainties, so it is very difficult to have near perfect estimates of cash receipts and payments, especially for a longer duration. It can be predicted for short duration such as of three to four months.
2. **Inflexibility:** If the finance manager fails to show flexibility in implementing the cash budget, it will incur adverse effects. If the

manager follows strictly adheres to the estimates of cash inflow it may negatively result in losing customers. Likewise, loyalty in payments may lead to deterioration of liquid position.

3. **Costly:** Application of this technique necessitates collecting of statistical information from various sources and expert personnel in operation research would be the costliest deal. It becomes expensive which may not be affordable to small business houses. In addition, finding out experts is not always possible. In this situation the long term predictions do not prove correct.

Model of Cash Budget

Particular	January	February	March
Opening Balance (A)	xxx	xxx	xxx
Add: Receipts:			
Cash Sales	xxx	xxx	xxx
Receipts from Debtors	xxx	xxx	xxx
Interest and Dividend	xxx	xxx	xxx
Sale of fixed assets	xxx	xxx	xxx
Sale of Investments	xxx	xxx	xxx
Bank Loan	xxx	xxx	xxx
Issue Shares & Debenture	xxx	xxx	xxx
Others	xxx	xxx	xxx
Total Receipts (B)	xxx	xxx	xxx
Less: Payments	xxx	xxx	xxx
Cash Purchases	xxx	xxx	xxx
Payment to creditors	xxx	xxx	xxx
Salaries & wages	xxx	xxx	xxx
Administrative expenses	xxx	xxx	xxx
Selling expenses	xxx	xxx	xxx
Dividend payable	xxx	xxx	xxx
Purchase of Fixed Assets	xxx	xxx	xxx
Repayment of Loan	xxx	xxx	xxx
Payment of taxes	xxx	xxx	xxx
Total Payments (C)	xxx	xxx	xxx
Closing Balance (A +B - C)	xxx	xxx	xxx

FIXED AND FLEXIBLE BUDGET:

1. FIXED BUDGET:

A fixed budget is prepared for one level of output and one set of condition. This is a budget in which targets are tightly fixed. It is known as a static budget .According to CIMA, "A budget which is designed to remain unchanged irrespective of the level of the activity attained." It is firm and prepared with the assumption that there will be no change in the budgeted level of motion. Thus, it does not provide room for any modification in expenditure due to the change in the projected conditions and activity. Fixed budgets are prepared well in advance.

This budget is not useful because the conditions go on the changing and cannot be expected to be firm. The management will not be in a position to assess, the performance of different heads on the basis of budgets prepared by them because to the budgeted level of activity. It is hardly of any use as a mechanism of budgetary control because it does not make any difference between fixed, semi-variable and variable costs and does not provide any space for alteration in the budgeted figures as a result of change in cost due to change in the level of activity. Fixed budget can be revised in the light of changing situations, yet the rigidity and control over costs and expenses would be lost in such cases. Fixed budgets should be prepared only where sales, production and costs can be accurately estimated.

2. FLEXIBLE BUDGET:

This is a dynamic budget. In comparison with a fixed budget, a flexible budget is one "which is designed to change in relation to the level of activity attained." The underlying principle of flexibility is that a budget is of little use unless cost and revenue are related to the actual volume of production. The statistics range from the lowest to the highest probable percentages of operating activity in relation to the standard operating performance. Flexible budgets are a part of the feed advance process and as such are a useful part of planning. An equally accurate use of the flexible budgets is for the purposes of control.

Flexible budgeting has been developed with the objective of changing the budget figures so that they may correspond with the actual output achieved. It is more sensible and practical, because changes expected at different levels of activity are given due consideration. Thus a budget might be prepared for various levels of activity in accord with capacity utilization.

Flexible budget may prove more useful in the following conditions:

- Where the level of activity varies from period to period.
- Where the business is new and as such it is difficult to forecast the demand.
- Where the organization is suffering from the shortage of any factor of production. For example, material, labour, etc. as the level of activity depends upon the availability of such a factor.
- Where the nature of business is such that sales go on changing.
- Where the changes in fashion or trend affects the production and sales.
- Where the organization introduces the new products or changes the patterns and designs of its products frequently.
- Where a large part of output is intended for the export.

Uses of Flexible Budget:

In flexible budgets numbers are adjustable to any given set of operating conditions. It is, therefore, more sensible than a fixed budget which is true only in one set of operating environment.

Flexible budgets are also useful from the view point of control. Actual performance of an executive should be compared with what he should have achieved in the actual circumstances and not with what he should have achieved under quite different circumstances. At last, flexible budgets are more realistic, practical and useful. Fixed budgets, on the other hand, have a limited application and are suited only for items like fixed costs.

Preparation of a Flexible Budget

The preparation of a flexible budget requires the analysis of total costs into fixed and variable components. This analysis of course is, not unusual to the flexible budgeting, is more important in flexible budgeting then in fixed budgeting. This is so because in flexible budgeting, varying levels of output are considered and each class of overhead will be different for each level. Thus the flexible budget has the following main distinguishing features:

It is prepared for a range of activity instead of a single level. It provides a dynamic basis for comparison because it is automatically related to changes in volume. The formulation of a flexible budget begins with analyzing the overhead into fixed and variable cost and determining the extent to which the variable cost will vary within the normal range of activity.

Model of Flexible Budget

	Particulars	**Capacity Utilization**		
		60%	80%	100%
(A)	**Variable Expenses:-**			
	Direct Material	xxx	xxx	xxx
	Direct Labour	xxx	xxx	xxx
	Direct expenses (if any)	xxx	xxx	xxx
	Total Variable Expenses (A)	**xxxx**	**xxxx**	**xxxx**
(B)	**Semi-Variable Expenses:-**			
	Maintenance & repairs	xxx	xxx	xxx
	Indirect Labour	xxx	xxx	xxx
	Indirect Material	xxx	xxx	xxx
	Total Semi-Variable Expenses (B)	**xxxx**	**xxxx**	**xxxx**
(C)	**Fixed Expenses:-**			
	Factory overheads	xxx	xxx	xxx
	Administrative Overheads	xxx	xxx	xxx
	Selling & distribution O/H	xxx	xxx	xxx
	Depreciation	xxx	xxx	xxx
	Total Fixed Expenses (C)	**xxxx**	**xxxx**	**xxxx**
	Total Cost (A+B+C)	**xxxx**	**xxxx**	**xxxx**
	(+) Profit	**xxx**	**xxx**	**xxx**
	= Sales	**xxxx**	**xxxx**	**xxxx**

TIME BUDGET:

With regard to time, budgets may be classified into four categories:

Long-term Budget: These budgets are prepared on the basis of long-term projection and portray a long-range planning. These budgets generally cover plans for three to ten years. In this regard it is mostly prepared in terms of physical quantities rather than in monetary values.

Short-term Budget: In this budget forecasts and plans are given in respect of its operations for a period of about one to five years. They are generally prepared in monetary units and are more specific than long-term budgets.

Current Budgets: These budgets cover a very short period, may be a month or a quarter or maximum one year. The preparation of these budgets requires adjustments in short-term budgets to current conditions.

Rolling Budgets: A few companies follow the practice of preparing a rolling or progressive budget. In this case companies prepare the budget for a year in advance. A new budget is prepared after the end of each month or quarter for a full year in advance. The figures for the month or quarter which has rolled down are dropped and the statistics for the next month or quarter are added.

MASTER BUDGET:

The master budget is a review budget which combines all functional budgets and it may take the form of Financial Statements at the end of budget period. It is also called the operating budget. It embraces the impact of both operating decisions and financing decisions. It provides the necessary plan for operations during the period when all detailed budgets have been completed. A master budget becomes a principal document for the operations of the industry during the period it covers. Actually, budgets have to be amended several times before the position disclosed by the summary budget is accepted. A master budget is an annual profit plan, which may be broken into months or quarters.

As a result a master budget is:

i) A statement of a company's operating policy for the budget period, and

ii) A budgeted profit and loss account for the budget period and a balance sheet as at the end the period.

Merits of the Master Budget:

A review of all the functional budgets in specific form is available in one report.

It presents an overall profit position of the organization for the budget.

It also contains the information regarding the forecast balance sheet.

It examines the fitness of all the functional budgets.

Performance Budgeting (PB):

Meaning:

The term performance implies results or outputs. ' A performance budget is one which presents the purposes and objectives for which funds are required, the costs of the programmes proposed for achieving those objectives, and quantitative data measuring the accomplishments and work performed under programme. Thus, PB is a technique of presenting budgets for costs and revenues in terms of functions, programmes and activities and correlating the physical and financial aspects of the individual items comprising the budget.

As per the National Institute of Bank Management, PB technique is, "the process of analyzing, identifying, simplifying and crystallizing specific performance objectives of a job to be achieved over a period in the framework of the organizational objectives, the purpose and objectives of the job. The technique is characterized by its specific direction towards the business objectives of the organization." As a result, performance budget accentuates the execution of specific goals over a period of time. Steps in Performing Budgeting (PB):

- Establishment of performance targets
- Establishment of responsibility centre
- Estimating financial requirements
- Comparison of actual with budgeted performance
- Reporting and action

BUDGET

Functional Budget – Sales Budget

1. J K Ltd. sell two products Jay & Kay in four area North, South, East and West. The following sales are budgeted for the month of January 2013.

North: - Jay 5,000 Units @ Rs 30 each, and Kay 3,000 Units @ Rs 15 each.
South: - Kay 6,000 Units @ Rs 15 each.
East: - Jay 7,500 Units @ Rs 30 Each
West: - Jay 4,000 Units @ Rs 30 each and Kay 2,500 Units @ Rs 15 each.
Actual sales for the same period were as follows.
North: - Jay 5,750 Units @ Rs 30 each and Kay 3,500 Units @ Rs 15 each.
South: - Kay 6,250 Units @ Rs 15 each.
East: - Jay 8,250 Units @ Rs 30 each
West: - Jay 4,750 Units @ Rs 30 each and Kay 2,625 Units @ Rs 15 each.
On the basis of all the relevant factors, the following sales are budgeted for the month of February 2013.
North: - Jay 6,000 Units and Kay 3,250 Units.
South: - Kay 6,500 Units.
East: - Jay 8,500 Units.
West: - Jay 4,500 units and Kay 2,750 Units.
It was decided that additional advertising campaign will be undertaken in South and East which will result in additional sales of 1,500 units of Jay in South and 2,500 Units of Kay in East.
You are required to prepare a sales budget for the month of February 2013 for presentation to management, also showing the budgeted and actual sales for the month of January 2013 which are to be provided as a guide in preparing the sales budget.

Production Budget:-

1. The following information has been made available from the records of precision Tools Ltd. for the six months of 2012(and the sales of January 2013), in respect of Product X.

(i) The units to be sold in different months are :

Month	Units	Months	Units
July 2012	1,100	November 2012	2,500
August 2012	1,100	December 2012	2,300

September 2012	1,700	January 2013	2,000
October 2012	1,900		

(ii) There will be no work in progress at the end of any month.
(iii) Finished units equal to half the sales of the next month will be in stock at the end of every month (including June 2012)
(iv) Budgeted Production and Production Cost for the year ending 31st December 2012 are thus:

Production (Units) 22,000
Direct Material Per Unit Rs 10.
Total Factory Overhead apportioned to Production Rs 88,000

You are required to Prepare:
a) Production budget for the six months of 2012 and
b) Summarized Production cost budget for the same period.

Functional Budget – Purchase Budget

1. The sales manager of Mahindra & Co. Ltd. reports that next year he expects to sell 50,000 units of a certain Product.

The production manager consult the storekeeper and casts his figure as follows. Two kinds of raw material A & B are required for manufacturing the product. Each units of the two products A & B are required for manufacturing the product. Each of the Product requires 2 Kgs of A and 3 Kg of B. The estimated opening balances at the commencement of the next year are finished product 10,000 Units; A, 12,000 Kg; B15,000 Kgs . The desired closing balance at the end of the next year are: Finished Product 14,000 units; A, 13,000 Kgs; B, 16,000 kgs.

Draw up a material purchase budget for the next year.

FLEXIBLE BUDGET

1. The following information relates to the productive activities of ABC Co. Ltd. For three months ended 31st December 1998

Fixed Expenses:	**Rs.**
Management Salaries	2,10,000
Rent and Taxes	1,40,000
Depreciation of Machinery	1,75,000
Sundry office Expenses	2,22,500
Semi- variable Expenses at 50% Capacity:	
Plant Maintenance	62,500
Indirect Labour	2,47,500
Salesmen's Salaries	72,500
Sundry Expenses	65,000
Variable Expenses at 50% Capacity:	
Materials	6,00,000
Labour	6,40,000
Salesmen's Commission	95,000

It is further noted that Semi-variable expenses' remain constant between 40% and 70% capacity, increase by 10% of the above figures between 70% and 85% capacity and increase by 15% of the above figures between 85% and 100% capacity. Fixed expenses remain constant whatever the level of activity may be. Sales at 60% capacity are Rs. 25,50,000; at 80% capacity Rs. 34,00,000 and at 100% capacity Rs. 42,50,000. Assuming that all items produced are sold, prepare a flexible budget at 60%;, 80% and 100% production capacities.

2. A flexible budget at 60%, 80% and 100% production capacities is to be prepared from the following information relating to the productive activities of XYZ Co. Ltd. For the six months ended 31st December 1997:

Fixed Expenses:-	**Rs.**
Management Salaries	42,000
Rent and Taxes	28,000
Depreciation on Machinery	35,000
Sundry office expenses	44,500
Semi-variable Expenses at 50% capacity :	
Plant Maintenance	12,500
Indirect Labour	49,500
Salesman salaries	14,500
Sundry Expenses	13,000
Variable Expenses at 50% capacity:-	
Materials	1,20,000
Labour	1,28,000
Salesman Commission	19,000

Semi-variable expenses remain constant between 40% and 70% capacity, increases by 10% on the above figures between 70% and 80% capacity, and increase by 15% only above figures between 80% and 100% capacity. Fixed expenses remain constant whatever may be the activity.
Sales at 60% capacity are Rs. 5,10,000; at 80% capacity Rs. 6,80,000 and at 100% capacity Rs.850000. It is to be assumed that all items procedure sold.

3. The following information at 50% capacity is given. Prepare a flexible budget and forecast the profit or loss at 60%, 70% and 90% capacity: -

Fixed Expenses :-	**Rs.**
Salaries	50,000
Rent and Taxes	40,000
Depredation	60,000
Administration Expenses	70,000
Variable Expenses :-	
Materials	2,00,000
Labour	2,50,000
Other expenses	90,000
Semi-variable Expenses:-	
Repairs	1,00,000
Indirect Labour	1,50,000
Other expenses	90,000

It is further noted that fixed expenses will remain constant at all capacities. Semi variable expenses will' not change between 45% and 60% capacity, will rise by 10% between 60% and 75% capacity, a further increase of, 5% when capacity crosses 75%. Sales at 60% capacity are Rs.11,00,000; at 70% capacity Rs. 13,00,000 and at 90% capacity Rs. 15,00,000

4. The following information relates to a flexible budget at 60% capacity. Find out the overhead costs at 50% and 70% capacity and also determine the overhead rate: -

Variable Overheads:	**Rs.**
Indirect Materials	8,520
Indirect Labour	10,500
Semi-variable Overheads:	
Repairs and Maintenance (70% fixed, 30% var.)	7,000
Electricity (50% fixed, 50% variable) ,	25,200
Fixed Overheads:	
Office expenses	70,000
Insurance	4,000
Depreciation	20,000
Estimated direct labour hours	1,20,000

5. Draw up a flexible budget for overhead expenses on the basis of the following data and determine the overhead rate at 70% and 90% plant capacity: -

Variable Overheads: (at 50% capacity).	**Rs.**
Indirect Materials	12,000
Indirect Labour	4,000
Semi-variable Overheads:	
Power (30% fixed, 70% variable)	20,000
Repairs (60% fixed, 40% variable)	2,000
Fixed Overheads :	
Depreciation	11,000
Insurance	3,000
Salaries	10,000
Estimated direct labour hours	1,24,000

6. The expenses budgeted for the production of 10,000 units in a factory is furnished below:

Particulars	**Per unit (Rs.)**
Materials	70
Labour	25
Variable overheads	20
Fixed overheads	10
Variable expenses	5
Selling expenses (10% fixed)	13
Administration expenses	5
Distribution expenses (20% fixed)	7
Total cost	155

Prepare a budget for the production of: (a) 6,000 units & (b) 8,000 units. Assume that Administration expenses are rigid at all levels of production.

7. The expenses for the production of 5,000 units in a factory are given follows: -

Particulars	Per unit Rs.
Materials	50
Labour	20
Variable Overheads	15
Fixed Overheads	10
Administrative expenses (5% variable)	10
Selling expenses (20% fixed)	6
Distribution expenses (10% fixed)	5
Total cost	116

You are required to prepare a budget for the production of 7,000 units.

8. A manufacturing company has the production capacity of 20,000 units per year. .The expenses for the production of 10,000 units is given below: -

Particulars	Per unit Rs.
Material	40
Wages (50% variable)	20
Manufacturing Expenses (40% fixed)	10
Administrative Expenses (Fixed)	5
Selling Expenses (60% fixed)	15
Total cost	60
Profit	20
Selling price	100

Prepare a Flexible budget to show 60%, 70%, 90% and 100% levels of activity. It is expected that the selling price will remain constant up to 60% activity, beyond which a 5% reduction in selling price will be necessary and above 90% activity, a 10% reduction in (original) selling price per unit will have to be made.

(2,00,000; 2,84,000; 2,98,000; 4,46,000; 4,20,000)

9. The following figures are available from the sales and cost forecast of ABC Co Ltd. For the year ended 31st December 1995 at 50% (5,000 units) capacity utilization. Prepare a profit-forecast statement through flexible budget at 60%, 75%, 90% and 100% capacity, Assuming that: -

1.Selling price between 50% & 75% capacity is Rs. 50 per unit.

2.Semi-variable expenses will remain unchanged at 50% to 60% capacities but will increase by 10% between 65% & 80% capacity and 30% between 80% and 100% capacity.

3.At 90% level material cost will increase by 5% and selling price will reduce by 5%.

4.At 100% level both material and labour costs increase by 10% and selling price will reduce by 8%.

5.Semi-variable expenses are Rs. 1,00,000.

6.Fixed expenses are Rs. 1,00,000.

7.Variable expenses are Material Rs. 10 per unit; Labour Rs. 4 per unit and Direct expenses are Rs. 2 per unit.

CASH BUDGET

1. From the following forecast of income and expenditure, prepare a Cash Budget for the months January to April 1995: -

Months	Sales	Purchases	Wages	Manufacturing Expenses	Administration Expenses.	Selling Expenses.
	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
Nov'94	30,000	15,000	3,000	1,150	1,060	500
Dec'94	35,000	20,000	300	1,225	1,040	550
Jan'95	25,000	15,000	2,500	990	1,100	600
Feb'95	30,000	20,000	3,000	1,050	1,150	620
Mar'95	35,000	22,500	2,400	1,100	1,220	570
Apr'95	40,000	25	2,600	1,200	1,180	710

Additional Information is as follows:-

1. The customers are allowed a credit period of 2 months.
2. A dividend of Rs. 10,000 is payable in April.
3. Capital expenditure to be incurred: Plant purchased on 15th January for Rs. 5,000; a Building has been purchased on 1st March and the payments are to be made in monthly instalments of Rs. 2,000 each.
4. The creditors are allowed a credit of 2 months.
5. Wages are paid on the 1st of the next month,
6 .Lag in payment of other expenses is one month
7. Balance of cash in hand on 1st January is Rs.15,000.

2. From the following forecasts of income and expenditure, prepare a cash budget for the three months commencing from 1st June when the bank balance was Rs.1,00,000

Months	Sales	Purchases	Wages	Fact. Exp	Admn. & Sell. Exp.
	Rs.	Rs.	Rs.	Rs.	Rs.
April	80,000	41,000	5,600	3,903	10,000
May	76,500	40,500	5,400	4,200	14,000
June	78,500	38,500	5,400	5,100	15,000
July	90,000	37,000	4,800	5,100	17,000
August	95,500	35,000	4,700	6,000	13,000

A sales commission of 5% on sales due two months after sales is payable in addition to selling expenses. Plant valued at Rs. 65,000 will be purchased and paid for in August and the dividend for the last financial year of Rs. 15,000 will be paid in July. There is a two months credit period allowed to customers and received from suppliers.

3. A Company expects to have Rs.25,000 in bank on 1st May 1995 and requires you to prepare an estimate of cash position during the three months May, June and July 1995:

Months	Sales	Purchases	Wages	Office exp.	Factory exp.	Selling exp.
	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
March	50,000	30,000	6,000	4,000	5,000	3,000
April	56,000	32,000	6,500	4,000	5,500	3,000
May	60,000	35,000	7,000	4,000	6,000	3,500
June	80,000	40,000	9,000	4,000	7,500	4,500
July	90,000	40,000	9,500	4,000	8,000	4,500

Other information:-

1. 20% of sales are in cash, remaining amount is collected in the month following that of sales.
2. Suppliers supply goods at two months credit.
3. Wages and all other expenses are paid in the month following the one in which they are incurred.
4. The company pays dividend to shareholders and bonus to workers of Rs. 10,000 and 15,000 respectively in the month of May.
5. Plant has been ordered and is expected to be received in June. It will cost Rs.80,000 to be paid in June.
6. Income tax Rs. 25,000 is payable in July.

4. Summarized below are the income and expenditure forecasts for the month of March to August 1994

Months	Sales	Purchases	Wages	Mfg. Exp.	Office Exp.	Selling Exp.
	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
March	60,000	36,000	9,000	4,000	2,000	4,000
April	62,000	38,000	8,000	3,000	1,500	5,000
May	64,000	33,000	10,000	4,500	2,500	4,500
June	58,000	35,000	8,500	3,500	2,000	3,500
July	56,000	39,000	9,500	4,000	1,000	4,500
August	60,000	34,000	8,000	3,000	1,500	4,000

Sales and purchases are all on credit.

You are given the following further information:-

a) Plant costing Rs. 16,000 is due for delivery in July, payable 10% on delivery and the balance after 3 months.

b) Advance tax instalments of Rs. 8,000 each are payable in March and June.

c) The period of credit allowed by suppliers is 2 months and that allowed to customers is one month.

d) Lag in payment of manufacturing expense is half month, while the lag in payments of all other is one month.

You are required to prepare a cash budget for 3 months starting on 1st May 1994 when cash balance was Rs. 8,000.

5. A newly started company wish to prepare cash budget for four months ending 30th June from the following estimated revenue and expenses

Month	Sales	Material	Wages	Prod. OHS	Selling OHS
	Rs.	Rs.	Rs.	Rs.	Rs.
January	20,000	20,000	4,000	3,000	800
February	22,000	14,000	4,400	3,300	900
March	24,000	14,000	4,600	3,300	800
April	26,000	12, 000	4,600	3,400	900
May	28,000	12,000	4,800	3,500	900
June	30,000	16,000	4,800	3,600	1,000

Cash balance on 1st March was Rs. 10,000. A new machine is to be installed at Rs. 30,000 on credit, to be repaid by two equal instalments in March and April. Sales commission @ 5% on total sales is to be paid in the month following actual, sales. Rs. 10, 000 being the amount of 2nd call may be received in March. Share premium amounting to Rs. 2,000 is also obtainable with 2nd call.

Period of credit allowed by suppliers 2 months.

Period of credit allowed to customers 1 month.

Delay in payment of overheads 1 month.

Delay in payment of wages ½ month.

Assume cash sales to 50% of total sales.

6. From the following budgeted figures prepare a cash budget in respect of three months to 30th June.

Month	Sales	Materials	Wages	Overheads
	Rs.	Rs.	Rs.	Rs.
January	60,000	40,000	11,000	6,200
February	56,000	48,000	11,600	6,600
March	64,000	50,000	12,000	6,800
April	80,000	56,000	12,400	7,200
May	84,000	62,000	13,000	8,600
June	76,000	50,000	14,000	8,000

Expected cash balance on 1st April is Rs. 20,000. Other Information:-

a) Materials and Overheads are to be paid during the month following the month of supply.

b) Wages are to be paid during the month in which they are incurred

c) Terms of sales: The terms of credit sales are payment by the end of the month following the month of sales; ½ of the sales are paid when due, the other half to be paid during the next month.

d) 5% sales commission is to be paid within the month following actual sales.

e) Preference dividend of Rs. 30,000 is to be paid on 1st May.

f) Share call money for Rs. 25,000 is due on 1st April and 1st June.

g) Plant and Machinery worth Rs.10,000 is to be installed in the month of January and the payment is to be made in the month of June.

7. Maharashtra Finance Co. Ltd. Started manufacture on 1st January 1994. The prime cost of a unit is expected to be Rs. 20 out of which Rs. 8 is for material and Rs.12 is for labour. In addition variable expenses per unit are expected to be Rs. 4 and fixed expanses per month will be Rs. 15,000. Payment for materials is to be made in the month following the purchase. One-third of sales will be for cash and rest on credit for settlement in the following months. Expenses are payable in the month in which they are incurred. The selling price is fixed at Rs. 40 per unit. The number of units manufactured and sold are expected to be as under:-

January 900 February 1,200 March 1,800; April 2,100
May 2,100 June 2,400.

Draw up a cash forecast ignoring the question of stock.

8. From the following data, forecast the cash position at the end of April, May & June 1993:

Month	**Sales**	**Purchases**	**Wages**	**Miscellaneous Exp.**
	Rs.	**Rs.**	**Rs.**	**Rs.**
February	1,20,000	84,000	10,000	7,000
March	1,30,000	1,00,000	12,000	8,000
April	80,000	1,04,000	8,000	6,000
May	1,16,000	1,06,000	10,000	12,000
June	83,000	80,000	8,000	6,000

Additional information:

Sales : 20% sales are in cash, discount allowed on cash sale is 5%.
Balance realised equally in two subsequent months.

Purchases : These are paid in the month following the month of supply.

Wages : 25% paid in arrears in following month.
Misc. Exp. : Paid a month in arrears.
Rent : Rs. 1,000 per month paid quarterly in advance due in April.
Income-tax : First instalment of advance tax is Rs. 25,000 due on or before 15th June.
Income from Investment: Rs. 5,000 received quarterly in April.
Cash in hand : Rs.5,000 on 1st April 1993.

9. From the following particulars prepare a monthly cash budget for the quarter ended 31st March 1998.

Month	Sales	Purchases	Wages	Expenses
	Rs.	Rs.	Rs.	Rs.
Nov.	50,000	10,000	20,000	4,000
Dec.	60,000	20,000	20,000	4,000
Jan.	40,000	30,000	22,000	5,000
Feb.	50,000	20,000	22,000	5,000
Mar.	60,000	10,000	24,000	5,000

Other information:

1. 10% of sales and purchases are on cash, balance on credit.
2. Credit allowed to debtors is 1 month. On an average 50% of debtors will make payment on the due date while the rest will make payment one month thereafter.
3. Credit period allowed by the creditors is 2 months.
4. Lag in payment of wages is 15 days.
5. Expenses are generally paid within the month.
6. Plant costing Rs. 10,000 will be installed in February on payment of 25% of the cost in addition to the installation cost of Rs. 500 balance to be paid in three equal monthly instalments from the following month.
7. Opening cash balance Rs. 20,000.

10. Estimate cash requirements of ABC Fruit Co. Ltd., on the basis of data given below: -

1. Sales February Rs.2,50,000
March Rs.2,00,000
April to June Rs.3,00.000 per month.

Roughly half of the sales are for cash, 90% of credit sales are collected in the month following sale and the balance one month later.

2. Fruits are always bought for cash to avail of the cash discount of 5%. The purchase Budget for the second quarter was 15,000 baskets per month at Rs 10 per basket
3. Wages and salaries for the second quarter were budgeted at Rs. 50,000 per month.
4. Manufacturing and other expenses budgeted for the quarter-

Cash Expenses Rs. 45,000

Depreciation	Rs. 75,000
Selling expenses	Rs. 30,000
Administration Expenses	Rs. 20,000(In April & May only)